Making Everything Easier!™

2nd Edition

Money Management For Canadians

ALL-IN-ONE DESK REFERENCE

FOR DUMMIES®

8 BOOKS IN 1

- Saving Money
- Debt Management
- Buying and Selling a Home
- Investing Essentials
- Stocks, Bonds, and Mutual Funds
- Retirement Planning
- Estate Planning
- Small Business

Andrew Bell
Andrew Dagys and Paul Mladjenovic
Tony Ioannou with Heather Ball
Margaret Kerr and JoAnn Kurtz
John Lawrence Reynolds
Kathleen Sindell

Money Management For Canadians

ALL-IN-ONE DESK REFERENCE

FOR DUMMIES®

2ND EDITION

by Heather Ball, Andrew Bell, Andrew Dagys, Tony Ioannou, Margaret Kerr, JoAnn Kurtz, Paul Mladjenovic, John L. Reynolds, and Kathleen Sindell

WILEY

John Wiley & Sons Canada, Ltd.

Money Management For Canadians All-in-One Desk Reference For Dummies®, 2nd Edition

Published by
John Wiley & Sons Canada, Ltd.
6045 Freemont Boulevard
Mississauga, ON L5R 4J3
www.wiley.ca

Copyright © 2008 by John Wiley & Sons Canada, Ltd. All rights reserved. No part of this book, including interior design, cover design, and icons, may be reproduced or transmitted in any form, by any means (electronic, photocopying, recording, or otherwise) without the prior written permission of the publisher.

Library and Archives Canada Cataloguing in Publication Data

Money management for Canadians all-in-one desk reference for dummies / Heather

Ball ... [et al.]. — 2nd ed.

Includes index.

First. ed. published 2003 under title: Money management for Canadians all-in-one desk reference for dummies.

ISBN 978-0-470-15428-1

1. Finance, Personal—Canada. 2. Investments—Canada. 3. Retirement—Canada—Planning. 4. Estate planning—Canada. 5. Small business—Canada—Planning. I. Ball, Heather II. Title: Money management for Canadians all-in-one desk reference for dummies.

HG179.M653 2008 332.02400971 C2008-902112-6

Printed in Canada

1 2 3 4 5 TRI 12 11 10 09 08

Distributed in Canada by John Wiley & Sons Canada, Ltd.

For general information on John Wiley & Sons Canada, Ltd., including all books published by Wiley Publishing, Inc., please call our warehouse, Tel 1-800-567-4797. For reseller information, including discounts and premium sales, please call our sales department, Tel 416-646-7992. For press review copies, author interviews, or other publicity information, please contact our marketing department, Tel 416-646-4582, Fax 416-236-4448.

For authorization to photocopy items for corporate, personal, or educational use, please contact in writing The Canadian Copyright Licensing Agency (Access Copyright). For an Access Copyright license, visit www.accesscopyright.ca or call toll-free, 1-800-893-5777.

LIMIT OF LIABILITY/DISCLAIMER OF WARRANTY: THE CONTENTS OF THIS WORK ARE INTENDED TO FURTHER GENERAL SCIENTIFIC RESEARCH, UNDERSTANDING, AND DISCUSSION ONLY AND ARE NOT INTENDED AND SHOULD NOT BE RELIED UPON AS RECOMMENDING OR PROMOTING A SPECIFIC METHOD, DIAGNOSIS, OR TREATMENT BY PHYSICIANS FOR ANY PARTICULAR PATIENT. THE PUBLISHER AND THE AUTHOR MAKE NO REPRESENTATIONS OR WARRANTIES WITH RESPECT TO THE ACCURACY OR COMPLETENESS OF THE CONTENTS OF THIS WORK AND SPECIFICALLY DISCLAIM ALL WARRANTIES, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF FITNESS FOR A PARTICULAR PURPOSE. IN VIEW OF ONGOING RESEARCH, EQUIPMENT MODIFICATIONS, CHANGES IN GOVERNMENTAL REGULATIONS, AND THE CONSTANT FLOW OF INFORMATION RELATING TO THE USE OF MEDICINES, EQUIPMENT, AND DEVICES, THE READER IS URGED TO REVIEW AND EVALUATE THE INFORMATION PROVIDED IN THE PACKAGE INSERT OR INSTRUCTIONS FOR EACH MEDICINE, EQUIPMENT, OR DEVICE FOR, AMONG OTHER THINGS, ANY CHANGES IN THE INSTRUCTIONS OR INDICATION OF USAGE AND FOR ADDED WARNINGS AND PRECAUTIONS. READERS SHOULD CONSULT WITH A SPECIALIST WHERE APPROPRIATE. THE FACT THAT AN ORGANIZATION OR WEBSITE IS REFERRED TO IN THIS WORK AS A CITATION AND/OR A POTENTIAL SOURCE OF FURTHER INFORMATION DOES NOT MEAN THAT THE AUTHOR OR THE PUBLISHER ENDORSES THE INFORMATION THE ORGANIZATION OR WEBSITE MAY PROVIDE OR RECOMMENDATIONS IT MAY MAKE. FURTHER, READERS SHOULD BE AWARE THAT INTERNET WEBSITES LISTED IN THIS WORK MAY HAVE CHANGED OR DISAPPEARED BETWEEN WHEN THIS WORK WAS WRITTEN AND WHEN IT IS READ. NO WARRANTY MAY BE CREATED OR EXTENDED BY ANY PROMOTIONAL STATEMENTS FOR THIS WORK. NEITHER THE PUBLISHER NOR THE AUTHOR SHALL BE LIABLE FOR ANY DAMAGES ARISING HEREFROM.

Trademarks: Wiley, the Wiley Publishing logo, For Dummies, the Dummies Man logo, A Reference for the Rest of Us!, The Dummies Way, Dummies Daily, The Fun and Easy Way, Dummies.com and related trade dress are trademarks or registered trademarks of John Wiley & Sons, Inc., and/or its affiliates in the United States, Canada and other countries, and may not be used without written permission. All other trademarks are the property of their respective owners. Wiley Publishing, Inc., is not associated with any product or vendor mentioned in this book.

Contents at a Glance

Introduction 1

Book I: Taking Stock of Your Financial Situation 7

Chapter 1: Your Financial Snapshot 9
Chapter 2: Setting Financial Goals 23
Chapter 3: Distinguishing Needs from Wants 33
Chapter 4: Saving Smartly 43
Chapter 5: Spending Wisely 49

Book II: Money Management Basics 59

Chapter 1: Getting Credit (Where Credit Is Due) 61
Chapter 2: Getting Into Debt 69
Chapter 3: Getting Out of Debt 85
Chapter 4: Budgeting and Record Keeping 113
Chapter 5: Planning for the Inevitable: Taxes 137

Book III: Home Sweet, Home Free 145

Chapter 1: Deciding to Buy 147
Chapter 2: Discovering Your Perfect Home 173
Chapter 3: Getting the Home You Want 201
Chapter 4: Deciding to Sell 221
Chapter 5: Preparing to Sell Your Home 243
Chapter 6: Sealing the Deal 261

Book IV: Investment Fundamentals 289

Chapter 1: Setting Realistic Goals and Expectations 291
Chapter 2: Your Savings Choices: Savings Accounts, Tiered Accounts, and GICs 299
Chapter 3: Stocks, Bonds, Mutual Funds, and Real Estate 305
Chapter 4: Monitoring Your Progress 327
Chapter 5: Becoming an Effective Investor 337

Book V: Making Your Investments Work for You 345

Chapter 1: Buying Mutual Funds 347
Chapter 2: Types of Mutual Funds 373
Chapter 3: The Essentials of Stock Investing 395

Chapter 4: Before You Get Started with Stocks 413
Chapter 5: Buying and Selling Stocks 433
Chapter 6: Investing in Bonds 447
Chapter 7: Screening Mutual Funds Online 459
Chapter 8: Internet Stock Screening 467
Chapter 9: Valuing Bonds Online 475

Book VI: Somewhere over the Rainbow: Retirement Planning 485

Chapter 1: Getting Started with Your RRSP 487
Chapter 2: What to Expect from Your RRSP 503
Chapter 3: Your RRSP Strategy 513
Chapter 4: Withdrawing Money from Your RRSP 529
Chapter 5: The Time Has Come to Cash In! 537

Book VII: Estate Planning 553

Chapter 1: Estate-Planning Basics 555
Chapter 2: The Taxman Cometh: Taxes and Your Estate 563
Chapter 3: Creating an Estate Plan 585
Chapter 4: Reading and Understanding a Will 617
Chapter 5: Power of Attorney and Your Living Will 633

Book VIII: Taking Care of Business 649

Chapter 1: Show Me the Money: Sourcing Financing for Your Business 651
Chapter 2: So Long and Thanks for All the Cash 671
Chapter 3: Paying Your Dues: All about Taxes 689
Chapter 4: Close Encounters with Accounting 707
Chapter 5: When Your Business Springs a Leak 723

Appendix A: Your Personal RRSP Planner 733

Appendix B: Prepare to Meet Your Lawyer 735

Appendix C: Instructions for Your Executor 747

Appendix D: Inventory for Your Executor 753

Appendix E: Sample Business Plan 759

Index 781

Table of Contents

Introduction 1

About This Book 1
Conventions Used in This Book 1
How to Use This Book 2
Foolish Assumptions 2
How This Book Is Organized 3
Book I: Taking Stock of Your Financial Situation 3
Book II: Money Management Basics 3
Book III: Home Sweet, Home Free 3
Book IV: Investment Fundamentals 3
Book V: Making Your Investments Work for You 4
Book VI: Somewhere over the Rainbow: Retirement Planning 4
Book VII: Estate Planning 4
Book VIII: Taking Care of Business 4
Icons Used in This Book 4
Where to Go from Here 5

Book 1: Taking Stock of Your Financial Situation 7

Chapter 1: Your Financial Snapshot 9

Figuring Out What You're Worth 10
Determining your income 10
Tracking your savings 11
Factoring in other assets 12
Figuring Out What You Spend 14
Keeping a spending diary 14
Using other tools to track your spending 15
Evaluating where your money goes 17
Identifying Your Money Personality 21
Saving for a rainy day 21
Spending like there's no tomorrow 21
Spending on a whim 22
Taking your time on a purchase 22

Chapter 2: Setting Financial Goals 23

What Are Your Goals: Then and Now 23
Determining Your Goals: A Five-Year Plan 25

Setting Priorities....26
Managing your money to accomplish your goals....26
Managing your time....27
Forming Strategies for Success....28
Be flexible but focused....29
Learn to live on less....30
Write This Down!....31

Chapter 3: Distinguishing Needs from Wants....33

What I Really Need Is 33
Housing....34
Food....35
Transportation....36
Clothing....36
Adding it up....37
What I Really Want Is 37
Understanding discretionary spending....37
Recognizing the influence of advertising (if you sell it, we will come)....38
Making Good Choices....39
Distinguish between needs and wants....39
Identify the opportunity costs and benefits....40
Choose what's best for you....40
Evaluate your choices....41

Chapter 4: Saving Smartly....43

The Benefits of Saving....43
Tips for Saving Money....44
Set up a separate savings account....45
Learn to live on less....45
Avoid credit cards....45
Reduce your taxes....46
Save all found money....46
After you pay a debt, save the same amount....47
Do your research....47
Use a piggy bank....47
Set up a buddy system....48

Chapter 5: Spending Wisely....49

Finding Alternatives to Spending....49
Spend, rent, or borrow?....50
Spend or barter?....51
Making Over Your Lifestyle....52
Use coupons rather than pay full price....52
Keep up with the Joneses, but get better deals....53

Remember that you don't have to spend a lot to have fun 53
Spend less and enjoy life more 54
Living on Less 54
Hanging On to Your Found Money 55
Earning Additional Income 56

Book II: Money Management Basics 59

Chapter 1: Getting Credit (Where Credit Is Due) 61

The Pros and Cons of Credit 61
Establishing Credit for the First Time 62
Deciding on an Acceptable Level of Credit 63
Avoiding the Credit Card Trap with the Two-Card System 65
Finding a good card 65
Using the two-card system 66
Understanding the Cost of Credit 67
Recognize signs of trouble 67
Cut credit costs 67

Chapter 2: Getting Into Debt. 69

Understanding Debts and Expenses 69
Credit 69
Debt 70
Expenses 72
Assessing Your Situation 76
Figuring out how much you owe 76
How did you get into debt? 79
Determining your priorities 81
Looking at your resources and assets 82

Chapter 3: Getting Out of Debt. 85

Putting Together a Budget 85
Determining and refining your debt repayment goals 85
Creating a budget 88
Evaluating your budget 94
Staying up-to-date 94
Using Your Budget to Get Ahead of Your Debt 95
Using your discretionary income to pay off high-interest debts first 95
Paying down other debts 98
Moving Money to Improve Your Debt Picture 98
Finding cheaper debt 99
Considering home equity loans 100
Finding more money 101

Filing for Bankruptcy Protection....104
Your best bet — Avoid bankruptcy....105
Understanding dischargeable and nondischargeable debts....106
Alternatives to bankruptcy....107
The consumer proposal....108
Starting bankruptcy proceedings....108
Determining whether bankruptcy is for you....110

Chapter 4: Budgeting and Record Keeping....113

Determining Your Essential Expenses: What You Need....113
Determining Your Nonessential Expenses: What You Want....114
Recognizing and Avoiding Hidden Expenses....115
Bank machine, bank, and credit card fees....115
Gratuities and delivery charges....116
Sales, luxury, and utility taxes....116
Factoring in Emergency Expenses....117
Accounting for Taxes....119
Paying Yourself First....120
Setting Up a Basic Budget....120
Sticking to Your Budget: Be Disciplined....125
Reining In Your Impulse Spending....126
Recognizing your triggers....126
Stopping yourself from making a purchase....128
Rounding Up Your Support Team....128
Spouse/significant other....128
Children....129
Parents....129
Friends....130
Professional and free services....130
Dealing with Emergency Expenses....132
Organizing Your Records....133
Creating folders for keeping your financial records....134
Keeping personal records....136
Staying organized....136

Chapter 5: Planning for the Inevitable: Taxes....137

Planning for Income Taxes....137
Staying informed....137
Getting organized....138
Deciding whether to itemize....139
Getting the records you need....139
Knowing what gets taxed....140
Reducing How Much Tax You Pay....140
Avoiding Tax Trouble....142
Staying alert to audits....142
Doing the right thing....143

Book III: Home Sweet, Home Free 145

Chapter 1: Deciding to Buy 147

Should You Buy Right Now? 148
Comparing renting to buying 148
Considering common homeowning concerns 150
Anticipating the typical costs for a new homeowner 150
Understanding the market 152
Getting Up Close and Personal with Your Finances 153
Understanding the Types of Mortgages 156
Conventional mortgages 156
High-ratio mortgages 156
Mortgage Basics and Jargon 101 156
Mortgage principal 157
Interest 157
Blended payments 160
Mortgage term 161
Mortgage-a-rama: All the Nifty Options 162
Portable mortgages 163
Assumable mortgages 163
Vendor (seller) take back mortgages 164
Builder/developer interest rate buy-down 164
Zero down payment 165
Line of credit 166
Mortgage Insurance 167
High-ratio mortgage insurance 167
Mortgage life insurance 168
Who Ya Gonna Call? 169
The information game: What your lender wants from you 169
Changing places: Questioning your lender 171

Chapter 2: Discovering Your Perfect Home 173

Selecting Your Home-Buying Team 173
Your agent 174
Your appraiser 181
Your lawyer 183
Knowing What You Want in a Home 186
Being pragmatic about your wishes 187
Making the list 187
Home Shopping Online 192
Smart start: The MLS listings 192
The independents: eBay and private sellers 194
Home Shopping Offline 195
Using your agent 195
Watching the neighbourhood 196

Monitoring MLS listings....196
Hearing the word (of mouth) on the street....197
Reading the news....198
Going to open houses....198

Chapter 3: Getting the Home You Want....201

The Contract of Purchase and Sale....201
Who's who and what's what in your contract....202
Reading all about terms and conditions ("subject to" clauses)....203
Scheduling the deal....205
Should it stay or should it go?....206
Signing it all away....207
The Ins and Outs of Inspections....208
Choosing a good inspector....209
Inspecting a newly built home....210
Anticipating the inspection....211
Condominium inspections....214
You Are the Owner of All You Survey....215
Understanding why you need a survey....216
Finding a professional surveyor....216
Does This Come with a Warranty?....217
Knowing what's covered....218
Understanding warranties....218

Chapter 4: Deciding to Sell....221

Good Reasons to Stay Put....221
Good Reasons to Sell....222
Timing: Sell First and Then Buy, or Vice Versa?....223
Riding the real estate cycle....223
Meeting your needs....224
Anticipating how much you can get for your home....224
Knowing what you can spend on your next home....225
The safety net: Conditional subject-to-sale offers....226
Buying time with the closing dates....228
Pricing Your Home to Sell....228
Knowing how much your home is worth....228
Avoiding the three most common pricing mistakes....230
Estimating the Costs of Selling....231
Agent's commission....232
Legal fees....232
Repairs or renovations....233
Discharge of your mortgage....233
Property taxes and prepaid utilities....234
Moving costs....234
Survey fees....235
Appraisal fees....235
Location-specific expenses....235
GST (Goods and Services Tax)....236

Dealing with Your Current Mortgage 236
Paying off your mortgage early 237
Letting your buyer take over your mortgage 238
Taking your mortgage with you to your new home 239
Reversing your mortgage 240

Chapter 5: Preparing to Sell Your Home 243

Identifying the Right Real Estate Agent 243
What to look for in your agent 244
What to ask your agent 247
Choosing to Go It Alone 248
Saving the commission 249
Working out the costs of selling it yourself 249
Hiring a Good Real Estate Lawyer 251
Picking the right real estate lawyer 251
Preparing to visit your lawyer 253
Taking care of business: What your real estate lawyer does for you 253
Listing Contracts 254
Selecting your listing type 254
Detailing your listing contract 256
Disclosure Statements 257
Who sees my disclosure statement? 257
What do I need to disclose? 258

Chapter 6: Sealing the Deal 261

Making Your House Shine 261
Undertaking home improvements 261
Creating curb appeal 263
Alluring interiors 264
Going to Market 264
Your basic For Sale sign 266
Advertise, advertise, advertise 266
Showing off: The open house 269
Recipe for a Successful Contract 270
A dash of offer 270
A handful of covenants, a sprinkle of conditions 272
A pinch of acceptance 279
Controlling the Negotiating Process 279
How low will you go? 280
"Only if you promise to . . .": Negotiating the "subject to" clauses 281
"I never liked those drapes anyway": Including appliances and household decor 283
The closing date 284
Mulling Over Multiple Offers 285
Considering Backup Offers 286

Book IV: Investment Fundamentals.....289

Chapter 1: Setting Realistic Goals and Expectations.....291

Understanding Risk and Reward.....291
What's the best you can hope for?.....292
What's the worst-case scenario?.....293
What's a realistic course?.....293
Realizing Gains through Compounding.....293
Focusing on a Goal.....295
Starting Your Savings Now.....296

Chapter 2: Your Savings Choices: Savings Accounts, Tiered Accounts, and GICs.....299

Starting with Savings Accounts.....300
Stacking Up Tiered Accounts.....301
Considering Guaranteed Investment Certificates.....302

Chapter 3: Stocks, Bonds, Mutual Funds, and Real Estate.....305

Sizing Up Stocks.....305
Understanding how stocks work.....306
Recognizing different types of stock.....307
Identifying potential stock investments.....309
Bantering about Bonds.....311
Understanding how bonds work.....312
Recognizing different types of bonds.....312
Identifying potential bond investments.....314
Defining Mutual Funds.....316
Considering different types of mutual funds.....317
Analyzing mutual funds.....320
Investing in Real Estate.....322
Buying your own home.....323
Buying an investment property.....324
Investing in a real estate investment trust (REIT).....324

Chapter 4: Monitoring Your Progress.....327

Checking Up on Savings Accounts and GICs.....327
Traditional savings accounts and tiered accounts.....327
Guaranteed investment certificates.....328
Looking at Performance: The Indices.....328
Canadian indices.....329
U.S. indices.....331
Remembering That Performance Is Relative.....333
Looking Rationally at Market Highs and Lows.....333
Reaching Your Goals.....334

Knowing When to Sell 334
Is the economy the reason for your investment's slump? 335
Is your stock falling behind? 335
Is your bond slipping behind? 336
Is your mutual fund fumbling? 336

Chapter 5: Becoming an Effective Investor. 337

Starting and Staying with a Diversified Investment Approach 337
Developing a Dollar Cost Averaging Plan 338
Investing with Your Eye on Taxes 339
Savings accounts 340
GICs 341
Mutual funds 341
Stocks 341
Bonds 342
Tax-deferred investing with RRSPs 342
The price you pay for tapping your retirement accounts early 342

Book V: Making Your Investments Work for You 345

Chapter 1: Buying Mutual Funds. 347

Checking Out Discount Brokers 347
Discovering what discount brokers are 348
Getting set up with a discounter 349
Selecting a discounter 350
Dealing with Your Friendly Neighbourhood Bank 352
The good news about buying where you bank 352
Buyer beware: Banking cons 355
Stockbrokers, Financial Planners, and Advisers Aplenty 356
Commissioned advisers 357
Fee-charging advisers 358
Salaried advisers 359
Finding the right professional 360
The right way to pick an adviser 361
The wrong way to pick an adviser 362
Buying Direct 363
The advantages of buying direct 364
The drawbacks of buying direct 370

Chapter 2: Types of Mutual Funds. 373

Equity Funds: The Road to Riches 374
Why investing in stocks is simple 374
The ABCs of picking a fund 376

Balanced Funds 380
Understanding balanced funds 380
Reviewing the problems with balanced funds 382
Bond Funds: Boring Can Be Sexy Too 384
Discovering some great reasons to choose bonds 385
Picking a good bond fund in 30 seconds 387
Money Market Funds: Welcome to Sleepy Hollow 388
Understanding how money market funds work 389
Selecting winning money market funds 390
Examining Other Types of Funds 392

Chapter 3: The Essentials of Stock Investing 395

Understanding Stock Market Basics 396
Why companies go public and sell stock 396
Canadian regulators and toothless tigers 398
Knowing How to Pick Winners 400
Recognizing stock value 400
Understanding how market capitalization affects stock value 401
Sharpening your investment skills 402
Matching Stocks and Strategies with Your Goals 403
Investing by Time Frame 404
Focusing on the short term 405
Considering intermediate-term goals 406
Preparing for the long term 406
Investing for a Purpose 407
Making loads of money quickly: Growth investing 407
Steadily making money: Income investing 408
Investing for Your Personal Style 410
Conservative investing 410
Aggressive investing 410

Chapter 4: Before You Get Started with Stocks 413

Reading (And Understanding) Stock Tables 414
52-week high 415
52-week low 415
Name and symbol 416
Dividend 416
Volume 416
Yield 418
P/E ratio 418
Close 418
Net change 419
Understanding Why Closing and Dividend Dates Matter 419
Going for Brokers 420
Distinguishing between Full-Service and Discount Brokers 421
Full-service brokers 421
Discount brokers 423

Choosing a Broker 425
Finding self-regulatory organizations (SROs) in Canada 425
Revisiting your personal investing style 426
Making the decision 426
Researching Online Investing Services 427
Getting online trading services for less 428
Trading online at a discount 428
Considering the Types of Brokerage Accounts 430
Cash accounts 431
Margin accounts 431
Option accounts 432

Chapter 5: Buying and Selling Stocks 433

Checking Out Trading Orders 433
Time-related orders 434
Condition-related orders 436
Pass the Margin, Please 441
Examining marginal outcomes 441
Maintaining your balance 442
Going Short and Coming Out Ahead 443
Setting up a short sale 444
Oops! Going short when prices grow taller 445
Watching out for ticks no longer 446
Feeling the squeeze 446

Chapter 6: Investing in Bonds 447

What Is a Bond? 447
Understanding what a bond represents 450
Looking at gilt-edged, blue-chip, and junk bonds 451
Knowing Why Strip Bonds Are a Good Choice 453
Deciding between Short-Term and Long-Term 454
How to Buy Bonds 455
Remember the "No Free Lunch" Rule 456

Chapter 7: Screening Mutual Funds Online 459

What Am I Screening? 459
How to Screen Mutual Funds Online 461
Buying Mutual Funds Online: No Broker Needed 463
Buying Mutual Funds Online: Using an Online Broker 464
Selling Mutual Funds Online 465

Chapter 8: Internet Stock Screening 467

Finding the Best Stock Electronically 467
Choosing the criteria for your first stock screen 468
Fine-tuning your stock screen 469

Using your stock screen results 469
Important ratios for screening stocks 469
Using Online Stock Screens 472
Using Stock-Screening Software 473
Using Those Terrific Prebuilt Stock Screens 473

Chapter 9: Valuing Bonds Online 475

Treasury Securities and You 475
The Math of Bonds 477
Calculating bond values 478
Creating yield curves 478
The easy way to value your bond returns 479
More Online Bond News, Rates of Return, and Advice 480
Where to Buy Bonds 481
How to buy 'em 482
Rolling over, cashing in, or selling your treasury securities 482

Book VI: Somewhere over the Rainbow: Retirement Planning 485

Chapter 1: Getting Started with Your RRSP 487

Basic Principles of RRSP Investing 487
Excuses, Excuses 489
Determine Your Maximum Contribution 491
Canada Revenue Agency limits 492
A little room for going over the limit 494
A second chance to contribute 496
The Foreign-Content Factor: R.I.P. 496
Monthly Contributions versus Lump-Sum Payments 497
Deductions at source 498
Borrowing to save 499
RESPs 500
Catching up big-time 500
Claiming Your Deduction 501

Chapter 2: What to Expect from Your RRSP 503

Growth Expectations 504
The Spectre of Inflation 505
How Much Will You Need? 506
Paying Attention 508
Spousal RRSPs and Income Splitting 509
Pledging Your RRSP as Collateral 511
Leaving the Country 512

Chapter 3: Your RRSP Strategy 513

Investments Suitable for Your RRSP 514
Matching Your Investment Mix to Your Goals 515
Savings accounts 516
GICs 516
Bonds 517
T-bills 517
Stocks 517
Mutual funds 518
Mortgages — Yours and others 518
Contributions in kind 519
Overcontributing and Undercontributing 520
Putting too many eggs in your basket (or, you can never have too many eggs) 521
Putting too few eggs in your basket 521
Review Your Progress 522
How to Read Your RRSP Statement 523
When It Makes Sense to Invest in Your Employer 526

Chapter 4: Withdrawing Money from Your RRSP 529

Why Your RRSP Is Not for a Rainy Day 529
Sharing your withdrawal with the CRA 530
Stunting your RRSP's growth 530
Squandering contribution limit: No double dipping 531
The added risk of spousal RRSP withdrawals 531
Combining RRSPs and RESPs 532
The Lifelong Learning Plan and Your RRSP 533
The Home Buyers' Plan and Your RRSP 534
Bowing Out Early 536

Chapter 5: The Time Has Come to Cash In! 537

The End of Your RRSP as You Know It 537
Moving from RRSP to RRIF 538
How an RRIF Works 539
Rules for RRIF withdrawals 539
Look for income, but keep your eye on growth 540
Looking at Other Options, Part I: Annuities 542
Why such a wide range in annuity payments? 545
Should you choose an annuity for your retirement income? 546
Looking at Other Options, Part II: LIFs and L-RIFs 547
Benefiting from Other Income Sources 548
Your C/QPP benefits 548
Your home 549
A Step-by-Step Approach to Making Decisions 550

Book VII: Estate Planning 553

Chapter 1: Estate-Planning Basics 555

What Exactly Is Your Estate? 555
Why Do You Need to Do Estate Planning? 557
What Tools Are Used in Estate Planning? 558
When Should You Make an Estate Plan? 560
Should You Get Professional Help? 561

Chapter 2: The Taxman Cometh: Taxes and Your Estate 563

Taxes on an Estate 563
Understanding capital gains 564
Capitalizing on capital losses 567
Taking in taxable income 568
Should You Leave Everything to Your Spouse? 569
Dealing with capital property 570
Distributing RRSPs and RRIFs 571
Should You Put Your Money into Your Principal Residence? 572
What is a principal residence? 573
But can you make use of the principal residence exemption? 573
Should You Give Things Away Now? 574
Will you actually reduce capital gains tax for your estate? 575
Will you actually reduce your income tax now? 576
Should You Freeze Your Estate? 576
A gift as estate freeze 577
A sale as estate freeze 577
A trust as estate freeze 577
A corporation as estate freeze 578
Should You Donate Something to Charity? 579
When the Taxman Finally Arriveth . . . With the Bill 580
Estimating the tax 580
Where will the money come from? 582
Make sure the wrong person doesn't get stuck with the bill 583

Chapter 3: Creating an Estate Plan 585

Accounting for Your Beneficiaries 585
The people you want to provide for 586
The people you have to provide for 589
The people you decide not to provide for 592
Understanding Your Executor 592
What does an executor do? 593
What are the legal responsibilities of an executor? 594
Choosing your executor 595

When your executor's not quite up to the job 596
What can happen if you choose the wrong executor? 596
Looking Out for Your Children 597
If one parent dies but the other is still alive and has custody 599
If one parent dies and that parent had sole custody 599
If both parents are dead 601
Appointing and safeguarding a testamentary guardian 602
The duties of a guardian 604
Protecting Your Business 605
You may already be sold short 606
You may have options 607
Timing is everything: When should you hand things over to your family? 610
Timing is everything: When should you sell? 611
Transferring or selling a sole proprietorship 612
Selling a partnership 613
Transferring or selling a corporation 614

Chapter 4: Reading and Understanding a Will 617

Get Ready, Get Set, Get Lost 618
Taking a Close Look at a Will 619
Identification 622
Revocation of other wills 622
Naming the executor 622
Leaving property to the executor in trust 623
Payment of debts 623
Distributing the remaining property to the beneficiaries 624
Executor's powers 628

Chapter 5: Power of Attorney and Your Living Will 633

Power of Attorney: The Solution to Your Management Problems 633
Powers of Attorney Come in Different Models 635
Enduring or continuing power of attorney 635
General or specific power of attorney 636
What's in a power of attorney? 637
What's Involved in Preparing a Power of Attorney? 638
The attorney 639
The powers 639
The process 640
Making Your Wishes Known through a Living Will 642
What does a living will say? 643
How do you make a living will? 645
After you've made a living will 647

Book VIII: Taking Care of Business 649

Chapter 1: Show Me the Money: Sourcing Financing for Your Business. 651

Your Business Needs Capital 651
Your Business Needs Operating Funds 654
Projecting your expenses and revenues 654
Preparing a forecast of revenue and expenses 655
Projected cash flow 656
Locating Sources of Financing for a Start-up Operation 657
Mix-and-match financing 658
Personal assets 659
Money from friends and family 659
Money borrowed from commercial lenders 660
Credit from suppliers and clients 664
Sale of accounts receivable 665
Government loans and grants 666
Arm's-length investment 666

Chapter 2: So Long and Thanks for All the Cash 671

Don't Panic! 671
First reason not to panic 672
Second reason not to panic 672
Third reason not to panic 672
Taking Your First Step 673
Filling Out an Application Form 673
Preparing a Business Plan 674
Checking Out What Goes into a Business Plan 675
A full-scale business plan 675
A mini business plan 676
Stating How Much You Want (Your Objective) 676
Describing Your Business 676
Your product or service 677
The goals of your business 677
Your business within the industry 678
Why your business can compete successfully 679
Your market 679
Your competitors 682
Explaining How Your Business Runs 683
Business info and history 683
Business managers 684
Business operations 684
Supplying Financial Information 685
Capital requirements of your business 686
Assets and liabilities of your business 686
Projected revenue and expenses of your business 686
Your personal capital 686
Providing References 687

Pulling the Final Product Together 688
Cover 688
Executive summary 688

Chapter 3: Paying Your Dues: All about Taxes 689

Income Taxes 689
What income is a business taxed on? 690
What is business revenue? 691
What are legitimate business expenses? 691
How much tax will you pay? 695
When and how do you have to pay? 697
If you've engaged in conduct 699
What records must you keep? 699
What if you're audited? 700
Collecting Sales Taxes 701
Provincial sales tax 701
Goods and Services Tax 702
Harmonized Sales Tax 704
Payroll Taxes 704
Business Taxes 704

Chapter 4: Close Encounters with Accounting 707

What's Accounting and Why Is It Important? 707
Starting with Bookkeeping 708
Saving pieces of paper 708
Recording your transactions 709
Sorting your revenue and expenses by category 711
Handling the bookkeeping burden 713
Practising Inventory Accounting 714
Monitoring with Internal Controls 715
Historical Financial Statements 716
Creating financial statements 716
The income statement 716
The balance sheet 718
Cash Flow Projections 720
Hiring an Accountant 721

Chapter 5: When Your Business Springs a Leak 723

Exploring Your Options when You're Out of Money 723
Your business can't make a payment that's due 723
You've personally guaranteed a debt for your business and your business can't pay 726
Your business can't pay its rent 727
Your business can't pay a mortgage on real property 728
Your business can't pay its taxes 729
Your business is insolvent 729
Declaring Bankruptcy 730

Appendix A: Your Personal RRSP Planner.....733

Appendix B: Prepare to Meet Your Lawyer.....735

Appendix C: Instructions for Your Executor 747

Appendix D: Inventory for Your Executor 753

Appendix E: Sample Business Plan.....759

Index.....781

Introduction

When planning for your financial future, you may sometimes feel like you're navigating a field plugged with all sorts of roadblocks and land mines and barbed-wire fences and any number of impediments, all designed to keep you from finding information you can apply to your specific needs. This book recognizes the challenges you face in figuring out how your home-buying decision relates to your investment choices, which relates to your estate planning scenarios, which may even relate to a small business opportunity. With *Money Management For Canadians All-in-One Desk Reference For Dummies,* 2nd Edition, you'll find much of what you're looking for to help you get out of that field of impediments and get into a secure and rewarding financial bunker.

About This Book

Like all *For Dummies* books, *Money Management For Canadians All-in-One Desk Reference For Dummies* is a reference — the kind of book that's most useful if you keep it by your side at all times, especially when making your most important money management and investment decisions. (Though if you make all your most important decisions during a time of contemplation in your shower, you may want to avoid that keep-it-by-your-side bit.)

If you're reading this Introduction at your neighbourhood bookstore — trying to decide whether to purchase this book — look around you at the dozens (or hundreds or even thousands, if you're at Chapters) of money management books you can choose from. With all those options, can one book possibly promise *all* the information you need about money management and investing? In a word, no. But this book does its best to give you all the information you need to get you on your way to a successful and rewarding financial future.

Conventions Used in This Book

Because some information in this book really deserves to stand out, you'll find certain conventions that apply to the following situations:

- Web site addresses appear in `this font`.
- Terms and phrases that may be unfamiliar to you appear in *italics*. You'll find an appropriate definition of the term or phrase nearby.

- **Bolded** words or phrases highlight the action parts of numbered steps or keywords in bulleted lists.
- The occasional sidebar (a shaded grey box) has information that's interesting to know but not necessarily critical to your understanding of a particular money management topic.

Throughout the book, you'll find cross-references to other sections that have information that adds to or supplements the content you're perusing. If a cross-reference directs you to a section in the same Book, you'll read something like, "Check out Chapter 4 for more information." If the cross-reference is to a different Book, look for something like, "Chapter 2 in Book V has more about this topic."

How to Use This Book

Because all *For Dummies* books are designed to be used as references, you never *need* to read one from cover to cover, though you're certainly welcome to do so if inclined. Here are a few suggestions as to how you may choose to read this book:

- **Go ahead and read it from page one to the index.** Even though it's designed as a reference, that doesn't mean it hasn't been organized in a logical manner. You'll find basic money management material toward the beginning of the book, with more specialized information toward the end of the book.
- **Make copious use of this book's table of contents and index.** Look up the topic you're interested in, find and read the information you need, and then put down the book and put your new-found knowledge to work. As an added bonus, the opening page of each Book has a brief table of contents for that Book only — look for the page with the cartoon on it.
- **Use the book as a paperweight to hold all your investment documents in place on a blustery day.** You won't get much money-management advice out of this use, but we hope you'll have already made good use of the book in that way.

Foolish Assumptions

The only real assumption made about you — the reader — is that this book makes no assumptions about you. You may be just getting out of school and ready to take on a career, or you may be looking for ways to minimize the hidden costs of

managing your estate. No matter your financial acuity, you're sure to find something in this book that will be helpful to you. Of course, some Books are more elementary than others, but even if you're already a savvy investor, you may surprise yourself and find something valuable in Chapter 1 of Book I.

How This Book Is Organized

This book has eight Books, each devoted to a specific money-management-related topic. You'll find some basic information and advice in just about every Book, but the following outlines what you'll find in each distinct Book:

Book I: Taking Stock of Your Financial Situation

Before trying to take on too much money management advice, you first need to assess your existing financial state. Are you a saver or a spender? What is your money personality? Do you have a good idea about what you *need* versus what you *want?* This Book helps you understand what kind of financial state of affairs you're in today.

Book II: Money Management Basics

The ABCs of money management really begin with the BCDs: budgeting, credit, and debt. If you can get a grasp on these fundamentals, you're off to a good start in getting your financial home in order. This Book helps you make sense of these concerns, all with a wary eye (or two) on how they impact your relationship with the tax man.

Book III: Home Sweet, Home Free

Buying your home may be the single most critical financial decision you make. No matter how you slice it, purchasing a home takes a great deal of money and even more financial planning. And what about selling your home, when the time comes? That's a challenging process, too, with a separate set of things for you to be concerned about. This Book offers advice on what you need to know to help you make the best home-buying and -selling decisions.

Book IV: Investment Fundamentals

This Book starts you on the road to developing your own investing strategies. After helping you figure out what investment goals and tactics are most comfortable (and rewarding) to you, this Book gives an overview of the types of investments available and how to develop an effective diversification strategy around them.

Book V: Making Your Investments Work for You

Whether you've reviewed Book IV to plan your investment strategy or you're comfortable enough with your investment goals that you don't need Book IV, Book V is the place to look for tips and tricks for selecting, buying, and monitoring your investments. This Book helps you know where to look for the best mutual funds, stocks, and bonds, as well as how to keep track of their performance — online and off.

Book VI: Somewhere over the Rainbow: Retirement Planning

Technically another Book for developing your investment strategies, this Book focuses on your post-career needs, RRSP-style. And when you're ready to start making RRSP investment decisions, take advantage of the easy-to-use RRSP planner in Appendix A.

Book VII: Estate Planning

You *do* have an estate. It may not compare in size and stature to those of Canada's wealthiest, but you do have an estate, and you need to make sure you earmark its fruits properly for those whom you love the most. This Book helps you develop an estate strategy that will save your loved ones hassle and tax money after you've gone on to your own great reward.

Book VIII: Taking Care of Business

Are you managing a small or mid-sized business in Canada? Or do you have lofty goals of opening the retail world's "next big thing" on the corner of your neighbourhood's busiest intersection? Or do you simply plan to start a little knitting business from your home, selling baby hats and grandma sweaters on eBay? This Book has the information you need to help you make your start-up business decisions, as well as how to manage your small business after you've, er, started up.

Icons Used in This Book

If you know your *For Dummies* books, you know your *For Dummies* icons, those little margin markers that alert you to particularly enlightening or helpful information. This book uses the following icons:

This icon highlights especially helpful advice that's likely to be right on target with your money management needs.

Stay alert when you spot this icon: The information it showcases is offered to help you avoid particularly damaging money management decisions.

Don't worry if you're not too alert around this icon. The information you'll find next to it is sure to be interesting or even entertaining, but it's not likely to be essential or critical to your money management plans.

Every topic has little tidbits of information that are useful to keep in mind for any scenario. This icon helps you — you guessed it remember them.

Yes, this book is a whopping 800-plus pages long. But you won't find the answer to every question you may have about your money management needs. This icon indicates some suggestions of where you may want to look for additional information.

Where to Go from Here

To your chequebook, your financial software, your calculator, or even your abacus. With this book (and those tools), you can start working on your money management goals immediately.

Book I

Taking Stock of Your Financial Situation

The 5th Wave By Rich Tennant

"It's really quite an entertaining piece of software. There's roller coaster action, suspense and drama, where skill and strategy are matched against winning and losing. And I thought managing our budget would be dull."

Contents at a Glance

Chapter 1: Your Financial Snapshot 9

Chapter 2: Setting Financial Goals 23

Chapter 3: Distinguishing Needs from Wants 33

Chapter 4: Saving Smartly 43

Chapter 5: Spending Wisely 49

Chapter 1

Your Financial Snapshot

In This Chapter

- Taking stock of your net worth
- Evaluating your spending habits
- Recognizing your money personality

Whether you're in Montreal, Medicine Hat, or Mozambique, just about every map you come across will likely have a "You Are Here" arrow. Why? Because you can't get to where you want to be if you don't know where you are. Your financial snapshot is a tool to help you map out and reach your financial goals, and it's useless unless you know where you are now and where you want to go. Determine your current financial situation by taking a thorough survey of your financial status. This chapter shows you how.

This chapter also helps you understand why considering your financial future is important. In both Canada and the United States, survey after survey shows the importance of getting a financial snapshot of your current situation as a starting point to mapping out and achieving your financial goals.

The growing focus on financial planning for Canadians is mainly because more people are realizing that those who plan well tend to accumulate less personal debt and save more than those who fail to plan their financial futures.

Recent surveys have also found that more Canadians are adjusting their financial plans than in earlier periods. Revisiting your financial plan is another key theme of this book. When your personal circumstances and goals change, your financial plans need to change accordingly to be effective.

The work we encourage you to do in this part of the book is just that — work. It involves calculators, research, phone calls, and coffee. But the end result will help you reach your personal goals by arming you with more financial resources and freedom. With finances firmly under control, you're much better poised to meet your retirement objectives — complete access to health care, lots of travel, and time for leisure! Failing to map out your financial condition can lead to scenarios best left to your imagination.

Figuring Out What You're Worth

When it comes to placing value in what you have, worth is much more than how much cash you have been able to stash away, whether in the form of salary, savings, chequing accounts, and so on. Determining your worth is an exercise that can include any number of decisions about any number of things that have value. Did you inherit a really ugly but valuable (to someone else!) vase from Uncle Ted? Save your memories, sell the vase, and factor the proceeds into your worth assessment.

Knowing your financial worth at any given point in time tells you where you stand relative to your goals. This information provides you with a reality check that may cause you to more fully turn on your income tap, and put a bigger plug in your expenses drain. If you have a large enough sink, you'll have saved a lot of cash for your future goals.

This section discusses some of the most common financial elements to include when figuring out what you're worth. Table 1-1 later in this section gives you a chance to do a quick calculation of your own net worth.

Determining your income

How much money do you take home after federal, provincial, and municipal taxes? The answer to that question depends on how you earn income.

The usual suspect: Your paycheque

How much is deducted from your paycheque for pension, income taxes, employment insurance, and health benefits? That net pay figure doesn't reflect your worth; rather, it gives you an idea of the money you have coming in on a regular basis. From that pool of steady income, you can build on those items of value that reflect your worth, whether they're material items such as a home or jewellery or investment items such as stocks or insurance policies.

Business income and the taxman

You can generate income from other sources as well. If you're a full-time entrepreneur or if you operate a part-time moonlighting business, you know your business exists to try to make money. Even when it doesn't succeed at first in generating positive cash flow, you can still get a bit of income from your business — with a little help from the taxman.

You can deduct reasonable business expenses for tax purposes. If those expenses happen to exceed your business income, voilà, you may generate some cash flow in the form of a tax refund. In fact, the Canada Revenue Agency (CRA) now has to go a bit easier on you in this regard, thanks to two landmark cases resolved by the Supreme Court of Canada.

Making business expenses work for you

Before you attempt to write off your expenses to generate cash income from a tax refund, consider the ability of your business to show a profit and whether your business has had profits or losses in the past. The CRA will be more likely to allow deductions where profitability has been demonstrated in the past; you're showing them that your business plan can work.

Financing your business may also help your case with the CRA. If you financed your business, it's one more way of telling the CRA that you are operating in a business-minded manner.

The court ruled that the CRA should not look for a "reasonable expectation of profit (REOP)," but instead should look at whether your business activity is "undertaken in pursuit of profit." In other words, the CRA has to consider whether you had an "intention to profit" from your business that is operated in a "sufficiently commercial manner." This is an easier set of tests to pass than the old REOP test. The new intention-based rules give you more of a fighting chance to deduct business expenses and even to get a tax refund for your efforts. Here, the taxman may be able to pay you!

Income from property

Thousands of Canadians own real estate properties that they rent out for income. Even more Canadians own investment property such as stocks and mutual funds that generate dividend and distribution income. When determining your income for the purpose of helping you calculate your net worth, don't forget to factor in the positive impact of income you get from your rental property, vacation property, or investments. Some of the most successful wealth-builders in Canada have used a *multiple stream of income* strategy to achieve financial independence. The majority of Canadian millionaires have an array of salary, rental, investment, dividend, and capital-gain income streams. Diversify your income if you can.

Unexpected windfalls

Don't forget to include temporary, part-time, or seasonal income, which you may want to treat as "found money," putting it directly into your savings or investment plan. With the benefits of a compound return, such investments may mean much to your future. You can read a detailed discussion of *compounding* (a return that is paid on a return already earned) in Chapter 1 of Book IV so you truly understand the benefits of forgoing small pleasures now for giant rewards.

Tracking your savings

How much money do you have in a bank, trust, or credit union savings account(s)? Do you have a money market account? Guaranteed investment

certificates (GICs)? For the purposes of figuring out your financial worth, your savings list includes *liquid assets,* or assets you can readily turn into cash.

If you find you have too many accounts in too many places, try consolidating them into fewer accounts. By consolidating, you can save fees, make tracking your assets easier, and make more money with accounts that pay higher interest.

Factoring in other assets

Other assets refer to those items — material or otherwise — that are less liquid than the ready-cash-at-hand savings accounts you have. By evaluating these assets carefully, you may find you can make them serve your purposes better by *liquidating* them (converting them into cash) and transferring their value to a more liquid asset.

While far from conclusive, your other assets may include stocks; bonds; mutual funds; retirement funds; insurance; real estate; and other investments, such as vehicles (land, water, or air!), jewellery, cash value of insurance policies, and collectibles (such as stamps or antiques).

Table 1-1 Your Assets

Type of Asset	Asset	Value
Cash	Chequing account(s)	_____
	Savings account(s)	_____
	Money market account(s)	_____
	GICs	_____
	Other	_____
Investments	Stocks	_____
	Bonds	_____
	Mutual funds	_____
	Commodities	_____
	Tax shelters	_____
	Options	_____
	Other	_____

Type of Asset	Asset	Value
Retirement funds	RRSP(s) or RRIF(s)	_____
	Company pension plan	_____
	Profit-sharing plan	_____
	Other	_____
Real estate	Equity in main residence	_____
	Equity in vacation home(s)	_____
	Equity in co-owned property	_____
	Equity in rental property	_____
	Other	_____
Insurance	Annuities, surrender value of	_____
	Life insurance, cash value of	_____
Personal Property	Airplane	_____
	Antiques	_____
	Art (paintings, sculptures, and so on)	_____
	Automobile	_____
	Boat	_____
	Camper	_____
	Collectibles (stamps, coins, etc.)	_____
	Deposits on empties	_____
	Gold and/or silver	_____
	Furniture, appliances, and so on	_____
	Jewellery	_____
	Recreational vehicle	_____
Other	_____	_____
	_____	_____
Total	**My assets as of** _____	_____

Now that you have listed your total assets (all the pluses), to get your net worth you must subtract your total liabilities (all the minuses). *Liabilities* are your loans, credit card balances, mortgages, lines of credit, and anything else you can think of: gambling markers, hockey pool IOUs, or bar tabs.

Figuring Out What You Spend

In your financial life, you may spend (or pay bills) until you have no more money. Then you wait for your next paycheque and start the process all over again. That approach may have worked (although not all that well) back in the days when you were collecting an allowance from Mom and Dad. It may have worked even in university — at least you wouldn't freeze. As time goes on, though, this "system" becomes less and less sound.

This section helps you figure out where you are currently spending your money so you can lay the groundwork for wiser, more informed decisions about your spending.

Keeping a spending diary

Keeping a spending diary helps you determine how you're spending your money on a day-to-day basis. For your diary, use a small notebook that fits in your pocket or purse. Carry it everywhere. Attach a pen or pencil to it so you have no excuse for not writing down every purchase you make. Every day. Every cent. Keep your spending diary for at least a month. Take a month off and start again, doing a month in each season. Good luck!

On each new page, write the day and date. Record all your purchases, whether you spent cash, used a credit card, or added to a tab. At the end of each day, total your expenses. (To make this exercise even more useful and meaningful, divide your weekly after-tax income by seven, write that amount on each day's page, and at the end of the day figure out whether you spent more than you made that day.)

Try one of these three ways to keep your diary:

- **Basic:** Create just two columns — one for the amount and one for a description.
- **Detailed:** Decide how many categories you want, and then draw and label your columns (you'll probably want to use two facing pages). Categories may include groceries, restaurant meals, snacks, transportation, clothing, and telephone calls.
- **Obsessive:** Draw fewer columns for wider categories, such as food, transportation, utilities, clothes, and miscellaneous. Write a key in the

front or back of your notebook so you can keep track of the items within each category. For example, under food you could use G for groceries, R for restaurant meals, S for snacks, and so on, as shown in Table 1-2.

You, of course, will want to create your own key based on your lifestyle. In Table 1-2, for example, B may stand for bus fare, F for fuel, N for newspapers, and C for a very expensive cup of specialty coffee (or clothing, if you're into that).

If your miscellaneous column adds up too fast, you probably need more categories. And if you find you're altering your spending habits as you keep your diary, don't write your totals until the end of the month.

Table 1-2 Sample Daily Spending Diary

Food	Transportation	Miscellaneous
R $10.50	B $5.25	N $2.75
S $2.50	F $39.48	C $39.00
G $33.88		

Using other tools to track your spending

Your bank and credit card statements can help you keep a handle on your spending. Rather than just checking to make sure the amounts are correct, use these records to find out how much money you spend in each category you use in your spending diary.

Using the information you've gathered, you can use pencil and paper to create a financial worksheet. Or, because financial software has become so inexpensive, portable, and easy to use, if you have a computer or handheld device like a BlackBerry or Treo, you may choose that way to keep track of your spending and saving habits.

The time you invest now to gather your information and understand your financial fingerprint pays off in easier tracking and decision making later. You've already made the decisions about your money; now you just have to apply them.

Reviewing your bank records

Every month, your bank, credit union, or other financial institution sends you a list of how much you put into your accounts and how much you spent out of them. Bank records are a good place to put your expenditures in categories using different-coloured highlighters: try green for savings and red for impulse purchases.

Your banking can be remarkably slick if you have Internet access and use online banking. All Canadian banks have systems where you can see current and even past records online. You can find out whether a specific cheque has cleared. You can check your current balance. You can check your records when it's convenient for you rather than waiting for the post office to deliver your statement. In addition, you can make your financial tracking life easier by using your computer to set up automatic payments for such expenses as

- Mortgage
- Utilities
- Telephone
- Credit cards
- Savings
- Investments

The easier you make it to keep track of your finances, the more likely you are to do it.

Monitoring your credit card statements

Those handy reports — or devastating reminders of how much you've spent and how much you owe, depending on your perspective — you get every month recording your credit card activity also help you draw your financial map. Signing on the dotted line to make a purchase is so easy many people do so much more often than they should. Again, using highlighters, mark each purchase to be tallied in a specific category.

Using financial management software

Computers can do many things for you. Luckily, keeping track of your money is one of them! Programs such as Quicken and Microsoft Money are inexpensive yet flexible. These programs do the basics, such as keeping track of your cheque record and balancing your chequebook. But that's just the beginning.

Like the paper worksheet in Table 1-3 later in this chapter, financial management software creates a budget for you according to your specifications. Even better than automatically calculating totals as you enter amounts, the software enables you to move items from category to category. (For example, you may want to move restaurant meals from a Food category to a Personal category — your choice.) This software enables you to be as specific or as imprecise as you want. You can create categories down to the *n*th degree, monitoring not only how much you spend in groceries but also how much of that you spend for meat, cereal, cookies, and ice cream — or whatever your idea of the four basic food groups may be.

Flexibility allows you to reorganize your budget so it gives you the information you want. When you've set up a budget, you aren't stuck with it. And as

your situation changes, you can customize your budget to reflect your new reality.

With your software package you can compare your forecast spending with your actual spending in any category, know when expenses are due with the use of a financial calendar, monitor your loan payments, manage your investments, and create reports and graphs to show how you're progressing toward your goals.

Don't put off budgeting because you don't have a computer. Software is nice, but not necessary. On the other hand, don't avoid using a computer or handheld device for budgeting simply because you're intimidated by them. You likely have a friend or family member who is comfortable with computers. (And any number of *For Dummies* books can help you through most computer or handheld device issues you may have.)

Evaluating where your money goes

With your spending diary in hand, you have the information you need to set up your budget. Knowing where money goes can help you keep it from going!

Table 1-3 is a budgeting worksheet that shows you what your spending history looks like. Using the last six months of bank and credit card records, figure your expenses in each category. For items that fluctuate, such as food, add up your six-month total (SMT). Then double that amount to get your yearly cost. Divide your SMT by 2 for your quarterly cost for that item. Divide your SMT by 6 to determine your monthly cost. Divide your SMT by 26 to calculate your weekly cost. Prepare to be shocked at how much you're spending in some categories.

Table 1-3 Budgeting Worksheet

Expenses	Weekly	Monthly	Yearly
Housing			
Rent or mortgage	_____	_____	_____
Condo association dues	_____	_____	_____
Maintenance	_____	_____	_____
Property taxes	_____	_____	_____
Insurance	_____	_____	_____
Furniture and appliances	_____	_____	_____
Other housing expenses	_____	_____	_____

(continued)

Table 1-3 (continued)

Expenses	Weekly	Monthly	Yearly
Utilities			
Gas			
Telephone			
Water			
Electricity			
Other utilities expenses			
Food			
Groceries			
Eating out			
Other food expenses			
Transportation			
Automobile lease/payment 1			
Automobile lease/payment 2			
Licensing			
Insurance			
Maintenance			
Gasoline			
Taxis and public transportation			
Parking/tolls			
Other transportation expenses			
Health			
Doctor(s)			
Dentist(s)			
Eye care			

Expenses	Weekly	Monthly	Yearly
Prescriptions			
Insurance			
Other health expenses			
Education			
Tuition/school fees			
Books and supplies			
School activities			
Other education expenses			
Personal			
Clothing, shoes			
Haircuts			
Cosmetics			
Pet care			
Childcare			
Child support (you pay out)			
Allowances			
Gifts			
Donations			
Membership dues			
Books and magazine and newspaper subscriptions			
Laundry/dry cleaning			
Hobbies			
Vacations			
Entertainment			
Other personal expenses			

(continued)

Table 1-3 (continued)

Expenses	Weekly	Monthly	Yearly
Investments			
Savings accounts			
RRSP(s)			
Mutual funds			
Bonds			
Other investment expenses			
Credit and loan			
Credit card 1			
Credit card 2			
Credit card 3			
Department store card			
Gasoline card			
Student loan			
Other credit and loan expenses			
TOTAL EXPENSES			
Income	**Weekly**	**Monthly**	**Yearly**
Wages, total			
Gratuities			
Royalties			
Dividends and interest			
Trust fund			
Pension			
CPP and EI			
Child support paid to you			
Gifts			
TOTAL INCOME			

With Table 1-3, you can know how much you're spending in each category. After you create a budget based on what you want to spend in each category and adjust your spending habits accordingly, you'll be able to tell when you overspend or underspend in a category. Neither situation is cause for despair or jubilation as long as your long-term expenditures stay within your personal range. If you consistently overspend, you may need to cut costs, or you may have underestimated your costs initially. On the other hand, if you consistently underspend your allowance in any category, you may be able to lower that budget item and reallocate the difference.

Identifying Your Money Personality

The best-laid plans are worthless if you can't follow them. To find the best plans for you, and to help you stick to your budget, you need to understand how you feel about money and how you react to money matters. This section describes a few of the most common money personality types.

You need to understand not only your own money personality, but that of your spouse or partner as well. (As you teach your children about budgeting and saving, you'll need to identify their money personalities, too.) When you recognize your money personality type, you can identify what habits you need to keep or change to reach your financial goals.

Saving for a rainy day

If your money personality is closest to a *saver,* you have trouble spending money even when doing so is in your best interests.

You may think that a saver wouldn't have any changes to make. But you can actually save to the point of hurting yourself. When going out of your way to save a few dollars or cents creates extra effort or inconvenience for you (or for your family or friends), you've likely "spent" where you could have "saved." For example, if you hire a cube van to move a few heavy items, and rush to return it before a deadline so you can save a few dollars or get back a deposit, you may cause yourself and those who are helping you to have a few aches and pains (literal and figurative).

Spending like there's no tomorrow

If you're a *spender,* your immediate reaction to available cash (or even available credit) is to figure out what you can buy with it. Sometimes you spend because you can't resist salespeople. Spenders use credit if they don't have cash, with no concern for the long-term consequences of that debt.

A spender has more problems to overcome than the obvious. The attitude that any money available is available only to spend, rather than to put in savings, is its own problem. But it's not unbeatable. If you learn to stop, evaluate, consider alternatives, and make a decision instead of reacting to the desire to spend (or giving in to a sales pitch), you'll have a more secure financial future. Millions of aging North Americans are only now realizing their savings are inadequate relative to their future goals. The good news is that many of these people have also begun to quickly shift gears to spend less, save more, and retire well!

Spending on a whim

If you're an *impulse buyer,* your spending habits are a little different from plain old spenders. When you see something you like, you buy it without evaluating the purchase in terms of your long-range goals. Impulse buyers react to one or two types of items (whereas spenders buy everything!).

An impulse buyer is similar to a spender. But an impulse buyer doesn't even have to "find" money available for spending. Just seeing something to buy is enough to bring out the wallet or credit card. The desirable habit to cultivate is the same as that for a spender. If you figure how many hours of after-tax income would be needed to buy an item, you can stop much of your impulse buying in its tracks. If you have a working sound system, for example, is it really worth hundreds of work hours to replace it with a new one?

Taking your time on a purchase

The last category is the *cautious buyer.* If this is your money personality, you are a serious comparison shopper who may waste more time making a decision than the item is worth.

Cautious buyers may waste both time and money. But time is money. Not only may a cautious buyer spend too much time gathering information about various features and comparing prices, but there's also the cost of phone calls and driving around. Even worse, a cautious buyer may not enjoy a purchase after making it if he or she sees the item on sale later. If you're a cautious buyer, use those good comparison-buying skills, but learn when enough information is enough to make a decision, and ignore any information you gather after the purchase.

If you have a lot of trouble making a buying decision, you may not need to buy that item at all.

Chapter 2

Setting Financial Goals

In This Chapter

- Setting realistic money management goals
- Establishing your financial priorities
- Selecting the best money management strategies for accomplishing your goals

After you take a picture of your net worth and your savings rate (refer to Chapter 1 for more), you're in a great position to take appropriate action with your money. Managing your money is a skill to be cultivated, just like developing your softball pitch or honing your fluency in a foreign language. As with any other skill, money management takes practice, realistic expectations, and the example and advice of those who have "been there and done that." This chapter is about setting realistic expectations for your personal finances, translating those goals into realistic actions in a proactive way.

Your path to financial security and economic success starts with this chapter. Here you can find out what it takes to become a skilled money manager and appreciate the rewards that good money management brings to your financial situation. Just do it, as Nike wisely implores. If you really want to get into this role, feel free to dress up in fancy Bay Street power threads and call yourself a money manager, even if it is only your money that you're managing!

What Are Your Goals: Then and Now

Graduating from high school or university may have been your most important goal in the past. Or maybe your biggest goal was to land a new job or get back on your feet after a divorce. Perhaps you've achieved those goals and haven't really given much thought to what comes next. Perhaps you have a vague sense that you want to pay off your debts, start a family, put your children through college or university, or start your own business. None of these or any other goals will happen unless you make them happen.

Achieving financial success isn't a matter of luck. Financial success requires attention, discipline, and sound money management.

Setting financial goals is something like going grocery shopping. You go to the store with a sense of what you need or want to buy. But the number of choices, sales, and attractive displays may cause you to get sidetracked.

You're starting with the desire to manage your money successfully so you can achieve your financial goals. But getting distracted is easy. Just as a shopping list helps a shopper stay focused, a money management list can help you get off to a good start. Take a minute to check off the items on the following money management "shopping list" that seem important to you. This shopping list can help you figure out your financial goals:

- Spend less than I make
- Make good consumer choices, and get good value for money spent
- Establish a good credit rating
- Curb my spending appetite
- Save some money every time I get paid
- Spend enough time on money management
- Take personal responsibility for managing my money
- Work out a budget
- Balance my chequebook
- Know where to get good financial advice
- Distinguish between short-term and long-term financial goals
- Keep good records
- Use banking services
- Pay my bills and taxes on time
- Eliminate my debt
- Reduce my taxes
- Plan my estate

How many items apply to you? Chances are you think you need to do *all* these things. And you do. But you don't need to do everything at once. What you need to do first are the basics. The basic approach to managing your money starts with knowing your financial goals.

In general, your goal is probably financial security. Almost everyone wants financial security. The trouble comes in defining just what financial security means to you. Start right now and complete this sentence:

I will be financially secure when I . . .

You may define financial security as being able to retire at age 65 without worrying about having enough money to live the rest of your life the way you want to. Or you may define financial security as being able to retire at age 50. The definition is up to you.

To get started on the road to financial security, begin to think in terms of the next five years. What can you do in the next five years that will help you accomplish your long-range goal of financial security?

Determining Your Goals: A Five-Year Plan

Sound money management is achieved through simple, realistic goals. After you have determined your personal financial goals, classify those goals as short-term or long-term. Making this distinction is important because it provides your financial strategy with direction. When you have your short-term, mid-term, and long-term goals clearly in mind, your goals become like building blocks. You can more easily defer some of the things you hope to accomplish in the short run because you know that with a longer time frame, those things will happen.

To help sort out your goals, ask yourself where you want to be financially in five years. In Table 2-1, indicate which of the following goals are important for you to accomplish within the next five years. On a scale of 1 to 5, 5 is very important and 1 isn't very important.

Table 2-1 Five-Year-Goal Worksheet

Goal	*[1]*	*[2]*	*[3]*	*[4]*	*[5]*
Reduce debt	[ ]	[ ]	[ ]	[ ]	[ ]
Save money	[ ]	[ ]	[ ]	[ ]	[ ]
Buy a car	[ ]	[ ]	[ ]	[ ]	[ ]
Buy a home	[ ]	[ ]	[ ]	[ ]	[ ]
Start an investment program	[ ]	[ ]	[ ]	[ ]	[ ]
Reduce income taxes	[ ]	[ ]	[ ]	[ ]	[ ]
Buy life insurance	[ ]	[ ]	[ ]	[ ]	[ ]
Take an expensive vacation	[ ]	[ ]	[ ]	[ ]	[ ]

(continued)

Table 2-1 *(continued)*

Goal	*[1]*	*[2]*	*[3]*	*[4]*	*[5]*
Put kids through university	[ ]	[ ]	[ ]	[ ]	[ ]
Other _____	[ ]	[ ]	[ ]	[ ]	[ ]
Other _____	[ ]	[ ]	[ ]	[ ]	[ ]

Look at the items you checked in the "5" column. Do you think it's realistic to try to accomplish all your 5's in the next five years? What do you think you can do in one year? The answers to these questions will help you focus on the important aspects of managing your money.

Setting Priorities

Wanting it all is easy — who doesn't want a nice place to live, clothes with logos and labels, a great car, meals at romantic restaurants, vacations, and so on? The list expands so easily. The fact is that you have limited resources. You must work with what you have — not with what you want to have, and not with what you think you will get next month or next year.

All managers wish for more resources to accomplish their goals. All managers wish they had more time, more money, more people, and more experience. But effective managers are resourceful and use what they have to get the best results. They prove their skills by accomplishing tasks with discipline and motivation — skills you can develop when you approach money management with the commitment to making do with the money you have.

Managing your money to accomplish your goals

Take another look at your five-year-goal worksheet in Table 2-1. If you selected debt reduction as a very important goal, you'll probably decide on money strategies that will make that goal happen. If you selected both reducing your debts and buying a great car, your money strategies will have to be different. In fact, you may realize your resources don't allow you to do both at the same time. One objective will have to take priority over the other.

From Table 2-1, select the three items you identified as most important to your short-term and long-term financial goals. Now rank those three objectives in their order of importance, as shown in Table 2-2.

Table 2-2 Ranking My Priorities

Priorities	*Short-Term*	*Mid-Term*	*Long-Term*
1.			
2.			
3.			

Do you think you need or want to make any adjustments to your worksheet? Chapter 3 examines the difference between money needs and money wants in greater detail. For now, stick with what you think you need to accomplish short term and long term.

Now estimate the percentage of your income you'll probably have to allocate to each of your top three priorities. Does common sense tell you these percentages are realistic? Pay attention to your common sense; it can become your best friend.

Write down what you know or expect your annual income will be this year before and after taxes and deductions.

Your *gross income* is your earnings before taxes and deductions get taken out of your paycheque. Your *net income* is your take-home pay — your earnings after all taxes and deductions. Your net income may seem like a lot of money, or it may seem like a pathetically small amount. In either case, as the manager of your money, you start with this amount.

Managing your time

Like the old adage says, "Time is money." Deadlines are a fact of both personal and professional life. As the manager of your money, you will struggle with many of the same constraints business managers experience. On the one hand, you'll wish you had more time to accomplish your goals; on the other, you'll wish you could see and enjoy the results of your work sooner.

To become a successful money manager, you have to become a successful time manager as well.

Everybody has the same 24 hours in each of the 7 days of the week. Yet some people just seem to get more done than others do. Why? Because they have clear goals, good time management skills, commitment, and discipline. You, too, can put time management and money management skills to work in order to accomplish your financial goals.

Do a quick review of your typical week. Estimate the time you spend working, sleeping, eating, travelling, reading, watching television, shopping, dating, interacting with family, and playing. Which activity takes the most of your time? Is that activity really the top priority in your life? Setting your work aside for a moment, how much time have you set aside for the things that will help you achieve your financial goals? What time do you have for managing your money so your priorities can become a reality?

Take the initiative to set aside half an hour every week (a weekend afternoon may be good, but find a time that works best for you) to develop your skills as an effective manager of your money and time. Time is undoubtedly one of your most valuable resources.

You can spend that half-hour doing any number of things. Consider the following:

- Make a list of your goals for the week.
- Review your out-of-pocket expenses against your budget.
- Read an article on personal finance.
- Call your financial adviser, trusted friend, or parent and ask for advice about a purchase or financial decision you expect to make in the coming week.
- Evaluate your money management skills during the past week and give yourself a grade. Target one area for improvement.
- Evaluate your time management skills during the past week and give yourself a grade. Target one area for improvement.
- Set aside $5 to $25 in an envelope for a special occasion.
- Identify at least one thing you believe you accomplished as a money and time manager during the past week.
- Start a weekly paper or electronic journal and enter a short list of your goals and accomplishments for the week.
- Compare your goals for the week against the priorities you set for yourself on the worksheet earlier in this chapter. Make adjustments.

Forming Strategies for Success

Some experts think that setting financial goals is the easy part of money management. The hard part is making it happen. The high-level plans you make to

accomplish your goals are called strategies. The thing about strategies is that you can change them.

Your plans or strategies for successful money management can change if you find they aren't accomplishing their purpose. Just as a business manager has to make adjustments to respond to one problem or challenge after another, you can become skillful in making adjustments to manage your money more effectively.

Although many strategies are available to you as a money manager, at least two guidelines can help you evaluate the success of a strategy:

- Be flexible but focused.
- Learn to live on less.

Be flexible but focused

As a money manager, you want to develop a balance between keeping your goals clearly in mind and responding creatively and constructively to changing circumstances and unforeseen situations. No one can anticipate every circumstance in life. Just when you think you can save a little more during one month, the car needs a repair you didn't count on. Or perhaps you see an ad in the paper for an item you really need. Although you hadn't planned to make the purchase now, you think that by doing so you would save money in the long run.

One of the best qualities of successful managers is good judgment. This is especially true of good money managers. Good judgment relates to common sense. Good judgment and common sense are not part of the school curriculum; you develop these in your life experiences.

Learning from your mistakes can be costly, but it's usually effective. Don't be afraid to change and try something else if one of your money management strategies isn't working.

Often, you learn good judgment by the example of others you know and respect. Encourage others to share their stories with you. From their stories about the decisions they've made, you'll learn about the good sense to be flexible. You'll learn the balance of keeping your eye on your goals while making adjustments for setbacks or unexpected difficulties.

Find the level of risk you're comfortable with. If you don't have family responsibilities, then taking greater risks may be easier. Taking the risk of changing

jobs is easier if you're single than if you provide for a family. Some people find investing in a speculative stock easier than others. Know yourself and your financial obligations.

Know that your goals may change as your circumstances change. Be flexible and replace goals that no longer suit your needs and wants. Your strategies may change because of proven successes and failures. Be flexible and make the necessary adjustments. If this approach sounds too vague to be useful now, test it out by asking someone whose judgment seems sound and whose decisions you respect. Ask that person, "Am I being too rigid about (name a goal, strategy, or specific circumstance)?" Or ask, "How can I be more flexible about (name the specific situation)?"

Learn to live on less

The single most important skill you can develop as a money manager is to live beneath your means. You've probably heard this guideline — the key to your financial freedom — expressed in many different ways: Live on less. Put something away from every paycheque. Save for a rainy day. All too many people avoid heeding this important advice.

In the section "Managing your money to accomplish your goals" in this chapter, you may have written down your net annual income. Try to imagine living on 90 percent of that income. Calculate how much you would need to save every month and every year to live on 90 percent of your net income. Think of a business manager who suddenly finds out the budget for a particular project has been cut by 25 percent. The project still must be completed on time and with the same quality standards. As your own money manager, you can appreciate the flexibility and commitment to your goal that such adjustments require.

If your ultimate goal is to attain financial security, chances are you won't be able to accomplish that goal on your income alone. The ticket to financial security is to save some of your money. If you don't manage to save some of your money on a regular basis, you won't have money to invest. Investment is a reliable way to accomplish the ultimate goal of financial security. The way to save money regularly is to live beneath your means. Investing allows your money to grow, so if you don't invest some of your money you can't achieve financial security. The logic is simple and compelling. (See Books IV and V for more details on investing.)

Put aside for the moment the wish to own that boat or fancy car. Now is the time to face reality and develop the skills you need to manage your money well enough to accomplish your financial goals.

Write This Down!

Chapter 3 focuses on making good choices about spending. Before you make those choices, however, you need to take the time to nail down some strategies:

- **Review your five-year plan.** On a blank sheet of paper, write down what you consider your most important long-term goal. This is what you hope to accomplish in about five years. Label that Goal A.
- **Look ahead a few years.** Write down what you consider your most important financial goal for the next two to five years. This is your mid-term goal. Label that Goal B.
- **Focus on this year's achievement.** Write down your most important financial goal for this year. This is your short-term goal. Label that Goal C.
- **Re-evaluate your long-term goals.** Take another look at your five-year-goal worksheet in Table 2-1. After each item, write A, B, or C if the item relates to any of your specific financial goals.
- **Summarize your strategies.** Make a chart that lists your short-term goal and the money management strategies that will help you accomplish that goal. Do the same for your mid-term goal and related strategies, and your long-term goal and strategies.
- **Track your progress.** Put your chart of A, B, and C goals and strategies on the refrigerator door so you're reminded of them every day.

Think now about the annual increase you can realistically expect if you stay with the same job for the next five years. These increases may seem large or small to you. In a way, the size of the increases doesn't matter. What does matter is that you accept the realities of your situation and manage your money accordingly.

If you postpone major expenditures (such as the purchase of a new car or an expensive vacation) now in order to accomplish your most important objectives, will you realistically be able to afford those expenses later, given the revenue you expect? Begin to think of adjustments you need or want to make in your expectations.

Chapter 3

Distinguishing Needs from Wants

In This Chapter

- Distinguishing your financial needs from your economic wants
- Recognizing the range of choices within the categories of needs and wants
- Making choices that relate directly to your financial goals

One of the responsibilities of being an effective money manager is to look at your financial situation objectively. Your objective eye lets you step back from the transactions you have conducted in the past and encourages you to look at the bigger picture of your financial situation. In practice, of course, this self-assessment process is easier said than done. But to help you stay disciplined, this chapter provides some guidance to help you fully consider what your needs and wants really are.

Look at the habits and attitudes you have developed up to now toward managing, spending, and saving your money. Have you made good choices thus far? As your own money manager, you want to make good choices for your hard-earned money. Making good choices involves distinguishing what you need now, and in the longer term, from what you only wish you had now.

What I Really Need Is . . .

Just what are the necessities of life? And how do these necessities change over time? Certainly, what you thought you needed at age 5 (a bike, a grilled cheese sandwich) would not be on your list of perceived needs when you are 15 (designer shoes, a new video game, a meal at the mall) or 25 (a new suit, a trip to Hawaii, money to pay the rent or mortgage, a romantic dinner on the town).

Start with the basics: You need housing, food, clothing, and some form of transportation to get to and from your job and other important places. But the range of choices for addressing those basic needs is staggering. Your cost, in terms of both money and opportunity costs, will vary greatly depending on your financial goals and the choices you make.

An *opportunity cost* is something you have to give up in order to pursue a particular decision. For example, if you decide to work late one evening, your opportunity cost involves giving up dinner with your family. If you decide to go to graduate school, your opportunity cost involves forgoing a higher standard of living in the immediate future in hopes of bettering your opportunities later in life.

Housing

Your housing choices may include living at home, renting an apartment, sharing an apartment or home with roommates, or buying your own place. For the sake of example, plug in some numbers for each of these options:

- If you rent a studio or one-bedroom apartment, your rent may run $800 a month.
- If you share an apartment or home with other roommates, your fair share may be $400 a month.
- If you buy your own house or condo, you may have to save $5,000 to $10,000 (at least) for a down payment, and your monthly mortgage may be $1,500 a month.
- If you take in a roommate or boarder to share your housing costs, or you take a smaller apartment or buy a smaller house, you can reduce your housing costs.

Your choice of housing depends on what you think you can afford as well as what you perceive the opportunity costs to be. Use Table 3-1 to apply the opportunity-cost concept to each housing choice, using figures that seem realistic for each choice listed.

Your perception of the benefit(s) derived from each choice is just as important as the opportunity cost. By adding a fourth column to Table 3-1, you can identify what you think the benefit(s) for each choice are.

Table 3-1 Monthly Housing Costs and Benefits

Choice	*Money Cost*	*Opportunity Cost*	*Benefits*
Rent an apartment			
Share housing with roommate(s)			
Buy a condo or house			
Take in a boarder			

Choice	*Money Cost*	*Opportunity Cost*	*Benefits*
Downsize housing			
Other _____			

What did you identify as the opportunity costs for sharing housing with roommates? Chances are, you mentioned a loss of independence. The opportunity costs associated with the other choices may involve settling for less in terms of the other major expenses in your life. For example, if you choose to rent a fancy apartment, you may have less to spend on a car. The choices you make for the basics depend on what you consider important in order to achieve the goals you identify in Chapter 2.

Food

Do you have any idea how much you spend on food each week or month? Are you counting fast-food stops and going to restaurants? Although food is certainly a necessity, you probably shouldn't count restaurant food as a necessity. Dining in a restaurant is usually considered entertainment. Eating out is something you want or enjoy more than something you need.

Use Table 3-2 before making decisions about the money you spend on food. Identify the opportunity costs and benefits for each of your options.

Table 3-2 Monthly Food Costs and Benefits

Food Choices	*% of Total Expenses*	*Opportunity Cost*	*Benefits*
Breakfast out			
Lunch out			
Dinner out			
Weekly groceries			
Other _____			

Sorting out your food choices and weighing the opportunity costs and benefits will help you make better money management decisions. You can discover how unwise it is to spend 40 percent of your net income on food when you also need to include in your budget costs for transportation and clothing. And you haven't even introduced all those things you want and are tempted to consider necessities — such as monthly cable, cell phone, and Internet access fees.

Transportation

In the category of transportation, too, you have a wide range of choices. Take a look at the choices you've made in the past to get a better idea of your money management patterns. Then fill in Table 3-3.

Table 3-3 Monthly Transportation Costs and Benefits

Transportation	*% of Total Expenses*	*Opportunity Cost*	*Benefits*
Car purchase payments			
Car lease payments			
Gasoline			
Insurance			
Maintenance, repairs, and so on			
Public transportation			
Other _____			

You already know that owning or leasing a vehicle is the most expensive form of transportation. And within the arena of owning a vehicle — car, minivan, sport utility vehicle, or motorcycle — many choices test your money management skills. You may want the best, but find you can't afford all you want. This is where the critical skill of distinguishing between your economic needs and wants is crucial.

You may decide you need a car. The car you choose can range from a top-of-the-line model with payments of $700 a month for five years to a clunker for less than $1,000 total (all before factoring in repair costs). Your choice relates to your financial goals and the economic means, or income, at your disposal.

Clothing

Clothing costs are perhaps harder to deal with. People generally don't spend a fixed amount on clothes each month. However, a major clothing purchase, such as a coat, could cause a big bubble in a monthly budget if you don't have good money management skills.

The choice in clothing is enormous. You have a sliding scale from designer labels to resale shops. You may love to shop for clothes, or you may hate to. Try to separate your love (or hate) for clothes shopping from the opportunity costs and benefits-specific clothes items.

Try to review your clothing costs for the last year. Begin by recalling major purchases. Estimate the number of times you go into a clothing store every week or month. Guess at how much you spend each time you make a purchase. The money you spend on clothes is probably greater than you think.

Adding it up

Using Tables 3-1, 3-2, and 3-3, tally the amounts you currently spend each month on the basics — housing, food, transportation, and clothing. Begin to think about the adjustments you want to make in any of those categories to accommodate greater spending (or savings) for any of your necessities. For instance, if buying a home is one of your priorities, then you can anticipate paying a greater amount for the "necessity" of housing. A greater commitment to your housing expense may well require spending less in another area of your budget.

What I Really Want Is . . .

One of the biggest differences between being an adult and being an adolescent is the amount of money you have available for "discretionary" spending. When you were a teenager, chances are your parents paid for your housing, food, and transportation. The money you earned, you spent — unless your parents insisted that you save some, or trained you in money management skills.

So fast-food, CDs, DVDs, video games, movies, "fashionable" clothing, and entertainment tickets often become the "necessities" of adolescents. Any survey of teenagers will likely indicate their top expenses are for entertainment, clothing, and music, not necessarily in that order. But for adults, these items fall into the category known as discretionary spending.

Understanding discretionary spending

Thinking of all the things you want outside the basic necessities as "extras" may be hard to do, but in the world of personal finance, that's reality. Take this opportunity for a reality check so you can recognize the distinction between what you need (necessities) and what you want ("extras").

As your own money manager, you may wish you had more money available for discretionary spending. And you may be appalled at which goods and services are commonly relegated to the category of "extras." Look over the following checklist (Table 3-4) of items you may consider ordinary parts of living. Indicate whether you think an item is a basic need (N) or a discretionary want (W).

Table 3-4 Allocating Needs and Wants

_____ Stockpot	_____ Pet
_____ Manicure	_____ Beer
_____ Down comforter	_____ Books
_____ Television	_____ Movie tickets
_____ Internet access	_____ Bread
_____ Vacation in Florida	_____ Videos
_____ Washing machine	_____ Stove
_____ Dishwasher	_____ Wallet
_____ Haircut	_____ Acupuncture
_____ Cologne	_____ Sweater

Count up your Ns and Ws. The list of wants should be far greater than the list of needs. Your needs list may include the haircut, bread, and sweater. Some people would argue that a wallet is a necessity; others may disagree. Still, only about 25 percent of these items can be considered real necessities.

The "extras" in your life far exceed your needs. One of the most difficult skills you have to learn as a money manager is how to say no to yourself.

Recognizing the influence of advertising (if you sell it, we will come)

One of the reasons you may have a hard time distinguishing between economic needs and wants is that advertisements are so persuasive. You're bombarded with advertising on the radio, on television, on the Internet, in the print media, and on billboards and buses.

The purpose of advertising is to promote goods and services so that the prospective customer psychologically transforms a want into a need. Companies spend a lot of money to create a look, feel, and message that works on your emotions. Companies test their products and marketing strategies on focus groups and use the feedback to develop even stronger messages for their targeted audience. In fact, many online ads are targeted to specific Web pages or are triggered by Google search entries. These ads are very highly aligned with a sponsor company's products and services.

One of your jobs as an adult is to liberate yourself from the compelling persuasions of creative advertising. One way to do so is simply to ask yourself a fundamental question: "Do I really need this (whatever it is)?" When you identify something as a want rather than a need, you gain control over the choice of whether to buy something.

Making Good Choices

Making good decisions about your hard-earned money is a skill you can build while playing the game of DICE. No, you're not going to gamble with your money; DICE is an acronym for

- **Distinguish** between needs and wants
- **Identify** the opportunity costs and benefits associated with each of your choices
- **Choose** an item based on your priorities, not on impulse
- **Evaluate** your well-chosen purchase as a gift to yourself

In the beginning, you may make some unwise choices. But as you gain experience as a money manager, your judgment will improve if you use the DICE approach.

Distinguish between needs and wants

As we discuss in the section "What I Really Want Is . . . ," get in the habit of distinguishing between what you need and what you want. Society encourages you to think that things you wish for are really things you need. Declare your independence and start making those judgments for yourself.

Your needs relate to the list of goals you develop in Chapter 2. Which of the following do you consider needs as opposed to wants?

____ Housing	____ Food	____ Transportation
____ Taxes	____ Insurance	____ Savings
____ Clothing	____ Utilities	____ Self-improvement

Chances are you consider all these categories essential to your financial success and your economic goals. Financial success is a result of the proper ordering of needs and wants, and allocating personal resources accordingly. For example, food is an essential item in every budget. Good money managers curtail the amount of money they spend on this item in order to save for other priorities.

What would you add to your list of essentials? Try limiting your list of essentials to ten items. These will become your priority list for later use.

Remember that within each category in your list of essentials, you have a multitude of choices. But limit the range to three: basic, middle of the road, and luxury. After each of your essential items, identify whether you want the basic, middle, or luxury choice in order to help you accomplish your financial goals.

Identify the opportunity costs and benefits

When you make decisions about spending your money to provide for the essentials on your list, remember the worksheets on housing, food, and transportation (Tables 2-1, 2-2, and 2-3) that helped you identify your options. For each option, you can name the opportunity cost — what you will give up to pursue a given option — and the benefit — what you will gain when you select that option.

All these steps may seem clumsy at first, but soon they'll become habit and you'll find yourself gaining both speed and confidence in identifying the relative benefits and costs of the choices you have. Weighing the relative costs and benefits enhances your skills as a money manager.

Choose what's best for you

Knowing what's best can seem difficult or confusing. That's why having your list of priorities close at hand is worthwhile. In Chapter 2, you have the opportunity to write down long-term Goal A, five-year Goal B, and one-year Goal C. Here, make a list of your ten most essential economic needs. Next to

each category on this list, write B for Basic, M for Middle of the Road, or L for Luxury to indicate what you think you will be able to afford. Put this list on the refrigerator.

Refer to these lists whenever you must make a decision about your essential economic needs. Obviously, choosing what's best for you involves selecting the option that's most in line with your stated goals.

Only you know your financial goals and economic priorities. Only you can make money management decisions that will help you achieve your personal goals.

Evaluate your choices

The way to continue making good money choices is to review your choices in terms of how they further your financial goals. Reward positive behaviour. Learn from the mistakes of poor choices as well. Both kinds of choices can develop your skills as a money manager.

Following are a few ways to reward yourself for using sound money management:

- Pat yourself on the back by doing something you enjoy — take a walk, enjoy a hot bath, spend some time in your garden, or sign up for an inexpensive art, cooking, or dance class.
- Share the good news — tell a friend or family member about your choice and why it feels good in terms of your priorities.
- Make a donation to a charitable organization or cause you support. Keep receipts of these donations so that if you itemize on your tax return, you can take a deduction. (For more on tax planning, see Chapter 5 in Book II.)
- Follow the DICE approach for another major purchase and feel good about how much better you are becoming at making wise choices.

Chapter 4

Saving Smartly

In This Chapter

- Understanding the role of savings in your financial security
- Motivating yourself with the benefits of a savings plan
- Using less of your resources now to accomplish your long-term goals

Every so often you may hear about an unexpected and generous bequest of some humble benefactor to a hospital or university. The article indicates the benefactor was a teacher or janitor making a modest amount of money. Somehow, over the years, the individual amassed a great fortune. The story usually indicates the person just lived frugally and saved a lot. The moral of those stories is that it isn't how much you earn, but how much you save, that makes the difference between financial success and just getting along. In fact, this is also a moral to a *Frugal Living For Dummies* book, another resource that can help you save for your future.

If you didn't develop the habit of saving money as a child, and you're tired of living from paycheque to paycheque, this chapter can help you find ways to save. This chapter also explains the benefits of saving, gives you tips on how to save, and shows you what to do with savings after they accumulate.

To discover the variety of investment vehicles in which to place your savings, check out Book IV.

The Benefits of Saving

Why save at all? Because your savings protect you from emergencies such as major car repairs or even a job loss. Your savings also allow you to make those major purchases, like car or home, that are so important to you. You can also convert your savings to investments that enable your money to grow.

Savings plans on the job

If you're lucky enough to work for a company that will help you contribute to your Registered Retirement Savings Plans (RRSPs), be sure to take advantage of that on-the-job perk. They calculate the percentage you authorize and deduct it right off your gross pay, and in many circumstances match it with a contribution of their own. This type of investment, just like your regular RRSP, decreases your taxable income and helps grow your retirement savings. So it's a win/win opportunity not to be missed. It's basically free money!

Without savings, you live with financial anxiety. Emergencies are a fact of life — not a surprise that strikes out of the blue. Your savings should include an emergency fund to deal with the "unexpected" disasters such as car repairs, a plumbing snafu, or a leaky roof. This emergency fund should be left alone and not used for investment purposes.

You have two other reasons to save your money. The first is to make major purchases, such as a house, car, or postsecondary education. The second is to make sound investments. Financial experts agree that the way to financial security and a comfortable retirement is to invest money so it will grow. The money you spend will not grow for you. The money you earn will not grow substantially unless you make sound investments. You will have no money to invest unless you save.

Savings are the key to financial security. Without savings, you won't have money to invest so that your money grows in value and your financial future becomes more comfortable. You can save money in many ways — whether it's by joining a savings plan at work or by creating your own regular savings habits. The important thing is to start saving something as early on in your life as possible.

Tips for Saving Money

The following tips can help you save the money you need to make your financial goals become realities. Remember that if you don't save you won't be able to afford the things you want, and you won't have a secure financial future.

Set up a separate savings account

Establishing a separate account for your savings is important because doing so enables you to watch your savings grow and see milestones. Don't let your savings "mingle" with your regular chequing account, because spending it would be too easy. If you keep your savings separate, it is more secure. You also earn a greater rate of interest on your savings account than you would if you left the money in your chequing account.

A separate savings account may help you avoid monthly charges on your chequing account. Many banks waive the monthly chequing fee if you also have a savings account with them, or if you agree to another one of their service offerings.

The first bill you pay out of your paycheque — whether you actually write a cheque or you have the amount automatically deducted — should be the savings amount you're committed to living without in the immediate future.

If you're employed, you can automate your savings process by arranging for automatic deductions at the source. For example, you can typically have as little as $25 taken from each paycheque and transferred automatically to your savings account or money market account. You can also have money automatically deducted and put into an RRSP or other type of investment.

Learn to live on less

Take a look at your net income. Whatever it is, reduce it (on paper!) by 10 percent. Then take that 90 percent figure as the amount you have to work with for your personal budget. What do you do with the 10 percent you "no longer have"? Put it in your savings account!

If taking 10 percent off your net income seems too drastic, then try this approach: When you next review your budget and pay your bills, write a cheque for 1 percent of your take-home pay and deposit it in your separate savings account. The second month, take 2 percent off the top of your take-home pay and put it in savings. Increase the amount by 1 percent each month. By the end of one year, you'll be saving 12 percent of your net income.

Avoid credit cards

Leave your credit cards behind. Impulse purchases are tempting when you carry plastic. These impulse buys add up, and they basically destroy your budget and erode your commitment to responsible money management.

When you pay by cash or cheque, you significantly reduce the amount you spend. As an added benefit, you avoid the absolutely outrageous credit card interest rates that compound in the blink of an eye.

Try to limit yourself to one or, at most, two credit cards. Consider the card an emergency backup, not a constant companion. Don't be lulled into thinking you need a credit card to establish your credit rating; you don't.

Avoid talking yourself into getting a credit card based on any incentive awards program that may be attached to it. See the big picture instead: Although it's nice to get points, or some other benefit, those rewards often come at a pretty high price. Sometimes people are compelled to buy unnecessary, expensive things just for the points, and end up shouldering oppressive interest payments as they struggle to pay the balance on their card. Ultimately, we bet you dollars to doughnuts the costs of these cards far exceed the benefits.

Reduce your taxes

Contributing to an RRSP may reduce your take-home pay, but it also reduces your tax liability. In other words, you are taxed based on the money remaining after your contributions are deducted from your gross income. A great way for Canadians to save is reducing the taxes they pay while at the same time socking money away for the future. RRSPs are an important part of any plan for financial security. Start your RRSP as soon as you can and contribute monthly rather than being part of the mad rush at the end of February. It is easy to arrange with your bank to contribute a set amount into your plan each month. The earlier you start building your fund, the more it will be worth when you retire.

Charitable donations also reduce taxable income.

Canada Revenue Agency has many free publications about tax planning that can help you reduce your taxes — you can order them online at `www.cra-arc.gc.ca` (click on the Forms and Publications icon on their home page). Or check out *Tax Tips For Canadians For Dummies* (Wiley) for expert tips and advice.

Save all found money

Consider all "found" or extra money as direct contributions to your savings plan. Found money can consist of monetary gifts, dividends, or interest income. Without delay, deposit this money in your special savings account and smile. Don't let yourself feel deprived or that you're being denied a

splurge. Instead, concentrate on the fact that you'll have the pleasure of seeing a long-term goal come true. A small, immediate pleasure is a low price to pay for a greater sense of accomplishment.

The longer you let gift money sit around at home, the less likely it is you'll save it.

After you pay a debt, save the same amount

What a great sense of relief you get when you pay off your car, your student loans, or an instalment loan! When you finish writing that last cheque, put down your pen and smile. But next month, when you go to pay your bills, write a cheque for the same amount (or even half the amount) and put it into your special savings account.

You learned to live with that debt as part of your fixed expenses. After the loan or debt is paid off, you can continue to do without that money.

Do your research

Most libraries have a good collection of books and materials on personal finances. Many also engage speakers who are experts in various aspects of finance and investing. Lots of people have good ideas about saving money. You can benefit from their experience and suggestions.

Even if you walk away with only one good idea per book, that idea will keep you growing as a money manager. And when you have accumulated some money in your savings account, you'll want direction about investing your hard-saved dollars. (See also Books IV and V for information about investing.)

Use a piggy bank

When you were a child, you may have been encouraged to make contributions to a piggy bank. Get a "piggy bank" for yourself now. A large jar, or something you can see through, is best. At the end of every day, empty the change from your wallet or pants pocket into the piggy bank. Next to the piggy bank, keep a notebook; in it, record the amount of change you put into the bank. At the end of every week, tally the amount you have contributed to the piggy bank.

Use the Internet for research

You can find many Web sites devoted to managing personal finances. In addition to publishing a print magazine, *Canadian MoneySaver* has a Web site (`www.canadianmoneysaver.ca`) where you can access a library of articles from past and current issues (for an annual subscription fee of $26.20). You also receive investment advice from scores of financial advisers, including financial planners, tax gurus, portfolio managers, investment advisers, lawyers, and others. This site also has helpful links to other specialized financial Web sites.

While you're online, check out `money.canoe.ca`, a Canadian Web site devoted to financial matters where the content is mostly free. SmartMoney.com and Bankrate.com are U.S.–based Web resources, but most of the money management principles they publish can be applied by Canadians as well. Again, much of their content is free!

If you can, set up a strategy for matching your piggy bank savings. When you tally the week's collection, add the same amount all at once to the jar. You can double your savings in a pretty painless way. Plan to take this money to the bank when your piggy bank is full to the brim or on a special occasion, whatever suits your personality.

Try not to just nickel-and-dime your coin contributions. You may be surprised how little you'll miss those loonies and toonies hanging around in your pocket or change purse.

Set up a buddy system

Saving money doesn't have to feel like drudgery, and it doesn't have to make you a miser. A little motivation from a friend can help. Think about finding a "money buddy" to help you save money regularly. Your money buddy can be someone from work, a relative, or a neighbour whom you know or suspect is also trying to save money.

Invite your money buddy to share a sack lunch with you one day a week, or if lunch isn't convenient, make it a phone call. Compare notes on your progress and offer each other encouragement. Swap ideas for saving money that you may have come across in an article or a conversation.

Chapter 5

Spending Wisely

In This Chapter

- Analyzing how you currently spend your money
- Cutting your expenses
- Making efficient financial choices
- Determining whether you need to make more money

Reducing your expenses may sound like a negative experience. Think of all the things you'll have to do without! When you pare back your expenses, however, you feel the delight of having your spending under control. A bonus is the disappearance of the stress of not knowing how you're going to pay your bills and plan for your future. When you make spending decisions before you even leave your home, and you know sticking to those decisions will help you meet your goals, you won't spend time and energy on every spending decision.

If your best planning still finds "more month than money," the solution is to increase your income. Like you never thought of that, right? The difference is that in the past, your "plan" consisted of dreaming "if only I made more money." In this chapter you'll explore how to figure the amount you need, how to determine whether your need is short-term or long-term, and how to know exactly where you can find your personal pot of gold.

Finding Alternatives to Spending

Chapter 1 suggests ways to monitor your spending, such as using various coloured highlighters to categorize your purchases as they appear on your bank and credit card statements, or using computer software to track your finances. No matter your method, categorize your spending so you can create your own wise spending pattern.

As you categorize your spending, you can change your categories or even add and subtract categories. One important note to remember is that your system shouldn't frustrate you to the point you stop your efforts to control your spending. Your financial health is important, so make your system easy to follow and stick to.

Spend, rent, or borrow?

When the lawn is as high as an elephant's eye, do you go out and buy a lawn mower? Doing so would seem logical . . . except that your lawn takes only half an hour to mow. Once a week. Maximum.

Does your neighbour have the hugest, most magnificent maple tree in the province — with piles of autumn leaves in the yard to go with it? Raking all those leaves is a big job — for one month out of 12. Is that month of activity really worth purchasing a leaf blower?

Chapter 1 includes a table in which you can start to list everything you own. If you've completed that table, expand the list by adding things you forgot and then writing down what each item cost and how often you use it. (And check out Chapter 3 for more about distinguishing between needs and wants.) Until you decided to get control of your spending, you probably thought you needed each of these things because you actually use them. Listing how much they cost and how often you use them gives you a whole new perspective.

Remember that the cost of insuring, maintaining, and storing rarely used items is an ongoing expense, even on appliances that are paid for. Make sure to factor these costs into your list.

For each item you own but rarely use, you have four choices:

- Keep it and use it until it wears out.
- Sell the item and then rent or borrow a replacement only when you have a need for it.
- Sell the item and then pay someone to perform that chore with his or her own equipment.
- Find a lower-cost alternative to the item.

After you pick one of these four choices, put a new cost on each item in your list. How much money could you free up by renting, borrowing, or co-owning?

Now that you have this information, how will you use it? The choices you have tell you not only what to do with your current appliances, but also how to handle future needs. For example, when the leaf blower can't huff and puff anymore, you have four choices:

- Replace it.
- Rent a leaf blower only when the leaves come a-tumbling down.
- Make arrangements to borrow someone else's leaf blower when the need arises.
- Use a rake.

Whether you're renting, borrowing, or co-owning, make sure your "partners" share your attitude on maintenance, cleanup, storage, and general care of tools and appliances.

Spend or barter?

With the proper incentive, anyone can make a deal. You may say you don't know how to barter, but return for a minute to your childhood and you'll see you've always had the skill. Remember the words, "But Mom, if you buy me this toy, I'll eat all my vegetables for a week"?

Even in the grown-up world, you have negotiating skills — and bartering is negotiating. Maybe you want your washing machine fixed, your lawn mowed, or your eavestroughs cleaned out. All you need to do is find something you can do for someone else in return for the service you need. For example, you help a friend with his résumé and, in exchange, he helps build you some bookshelves.

You have skills to trade, too. Think about the things you can do that other people want done for them. Make a list of all the skills you use at work or in pursuing your hobbies — designing Web sites, filling out tax returns, hanging wallpaper, taking photographs, and so on. Remember that personal skills (for example, closet reorganizing) and thinking skills (for example, planning a vacation) are tradable, too.

Using a fresh piece of paper (or a new computer file), start a list of all your skills. Keep this list with you. As you go about your life, you'll think of more and more skills to add to this list. You may want to divide the list into things you're willing to do, things you'll do if you have to, and things you don't ever want to do again.

Consider bartering clubs, which may facilitate this part of your money management. To find a bartering club, look in your local Yellow Pages, search the Internet, ask a librarian, or check with neighbourhood organizations, professional and trade associations, service organizations, alumni associations, and churches.

Every club has its own rules, but, like any other organization, someone has to pay the organization's costs. These include accounting, mail costs, promotion fees, and so on. If you're interested in joining a bartering club, you need to know the following information:

- Is there a fee to join? An annual fee?
- What fees are assessed on barters?
- Who belongs now? (Get a list.)
- Are the club membership and services growing or shrinking?
- How long has the club been in existence?
- Can you drop your membership whenever you want, as long as you "pay" whatever outstanding "debt" is in your account?

Find out as much as you can about a club before you join. If other members aren't reliable, are so fussy they'll always complain about your contribution, or live so far away they can't fulfill your needs, don't join.

Making Over Your Lifestyle

Giving your lifestyle a makeover is not the same as lowering your standard of living or depriving yourself. In fact, it can be quite the opposite. The emphasis here is on style. As the preceding sections on sharing and bartering demonstrate, a lifestyle makeover involves an attitude shift that will help you get the most for your dollar. The following sections can help you reach your financial goals.

Use coupons rather than pay full price

The art of saving money by using coupons is a consumer industry in itself. Whether you've never used coupons or you use them and want to get more from your efforts, the tips in this section can help you meet your goals.

"Couponing" is a skill for which reading carefully really pays off. First, you have to find coupons. Check newspapers and newspaper inserts, the packaging of items you've already bought, the back of your supermarket receipts,

and coupon trade boxes inside stores, to name a few sources. Before buying a product you know you want, check out company Web sites for coupons and other promotional items. This approach works especially well for food and pharmaceutical items.

Don't buy something just because you have a coupon for it. If you won't use the product for a while, you have to store it; if it's something you don't like, you'll never use it.

Keep up with the Joneses, but get better deals

Membership warehouse clubs, such as Costco or Sam's Club Canada, can come to your aid with special deals. Because these organizations buy in bulk, they often get a lower rate and can pass those savings along to you.

If you're planning a car trip and a gasoline credit card offers hotel discounts, this may be the time to obtain that card. If you have trouble with overspending on credit cards, you can close out your account as soon as the trip is over.

Remember that you don't have to spend a lot to have fun

When you first determined to get your financial house in order, you probably thought entertainment was going to go by the wayside. Even with cable, television is a pretty poor long-term amusement. Luckily, you have many other options.

- **Support — and enjoy — the arts.** If the theatre, the opera, live music, and so on are your passion, you can enjoy them without breaking your budget. Many performances offer discounted rush seats on the day of the show.
- **Cruise for deals.** Some travel agencies sell off cruises and other deals at very good prices to people who can fill vacancies at the last minute. You can buy into these deals at 50 percent or less of the listed price. Sometimes you have to become a member of a travel group's club to be notified of an opening. Will you use or save enough to make membership fees worthwhile? These discounted offers are great, especially for retirees and self-employed people, whose schedules are more flexible.

- **Browse for can't-beat airfare.** Nearly all the major airlines offer last-minute airfare deals that allow you to take off on spur-of-the-moment weekend trips. You have to sign up to receive these e-mail updates, and they often include special rates on car rentals and hotel rates in the destinations to which the special fares apply. Check out individual airline Web sites, or go to `ca.travelzoo.com`, an online discount travel site that does trip searching and helps you book trips, too. Travelzoo's offerings cater to last-minute deals and sell-offs.

Spend less and enjoy life more

Look for your own opportunities to reduce your expenses without reducing your quality of life. Instead of always looking to your wallet to pay for entertainment, use the creative skills you've been developing. Knowledgeable, reliable people are in demand everywhere.

- Does your child's class need a chaperone for a school trip? Volunteer for the job.
- If you can't devote the time to be a regular usher at a theatre, offer a skill or time in trade for attending a dress rehearsal.
- If you like sports, find out what personnel are needed to put on an event. Could you be an assistant coach for a children's soccer or baseball league? Can you help organize a local tennis tournament?
- Can you speak a second language? Offer a friend language lessons in exchange for her teaching you to play guitar.

Living on Less

If you went to the store to buy one size and brand of bread and could pay either $2 or $2.50 for it, which would you choose? Sounds like a dumb question, doesn't it? Yet every day, people make the wrong decision.

Here are some ways to live on less without sacrificing quality of life:

- **Dig for deep discounts:** Shop at very-deep-discount stores instead of convenience stores, and buy the same items for less. Browse the Internet for a local or area-wide directory of discount and outlet stores.
- **Brown-bag it:** Take your lunch to work instead of buying it; you'll have a healthier lunch and save money, too.

- **Telecommute, if you can:** Negotiate with your employer to work at home. You can save restaurant, travel, car wear-and-tear, and clothing expenses.

  Negotiate who is going to pay for equipment, telephone lines, and other expenses. If those expenses are your responsibility, you may be spending instead of saving money.
- **Analyze your purchase decisions:** Understand your real goal before you make a purchase. If you want to lose weight, you can do so for free by walking in the park or by taking advantage of the company gym. Either one is cheaper than signing a contract at an exercise facility.
- **Consider the "previously owned":** A used car is new to you. Not only do you pay less, but your insurance costs are less than on a new car, your depreciation is slower, and you don't have to dread that first ding in the door.
- **Always use a shopping list:** Just as the lines on the highway keep you driving in the lane, a shopping list keeps you from giving in to temptation. Even if you decide to purchase something not on your list, you will have considered and weighed the purchase.

Hanging On to Your Found Money

The fastest way to undo all your hard work is to think of your money as a tradeoff between spending on one item and spending on another. Yes, you can take advantage of the savings that come from buying in quantity — if you've figured in waste, storage costs, and the other possible expenses of having a large quantity of one item on hand.

If you release yourself from always worrying about money by reducing your expenses, you may feel "rich" because you at last have cash in your pocket. That "found" money should go first toward debt reduction (as Chapter 3 in Book II discusses in depth) and then toward savings (see Chapter 4).

Does paying off debts and then putting money toward savings mean you don't get to enjoy the fruits of your labour? Of course not. You get to enjoy being free from worry, seeing your debts disappear, and watching your savings grow.

While you're paying off debts and starting a savings program with your found money, don't even think about the credit available on your credit cards. Using that credit means more debt, which is exactly what you don't want.

Earning Additional Income

If all your money-saving, coupon-cutting, and planning still leave you short of achieving your goals, look for ways to earn more income.

- **Get a raise — yes, it's possible!** Contact trade associations, your alumni association, and unions, and do research at the library or on the Internet to find out what others doing your job are earning. If you find your wage is lower than average, take your research to your boss and ask for a raise.
- **Take an inventory of your skills.** Look for skills you use at work but maybe aren't appreciated by your boss and aren't being recognized in your paycheque. Bosses don't have to think about what's going right — so they don't! You need to remind your boss about your accomplishments. If you can prove you're underpaid, negotiate a raise.
- **Allow your hobbies to earn you extra money.** For example, if you know how to work with wood, you can sell the furniture you build or help people build things for a fee. You may have to do a little research to see how much you should charge customers, but hobbies still are a good source of income that's a pleasure to earn.

You not only need to survey your knowledge and skills to see where you might earn extra income, but you also must decide how much you want to earn and what it will cost you to do so. Remember to calculate material and tool expenditures as well as time expenditures. Will you recoup your investment? Will you have enough income to write off those expenditures on your income taxes as business expenses?

Think about whether you want to take on any extra work for a short, medium, or long period of time.

- **Short-term need:** If you want to do extra work only long enough to pay off your credit card or other debt, you may want to look for seasonal work or register with a temporary-employment agency. Because you won't be working extra for a long time (you get to define "long"), you'll probably have the energy to work longer hours, work more days per week, commute a little farther, and so on.
- **Mid-term need:** If this extra job is going to go on for a while because you need the extra income for a longer period, such as while your child grows up, you don't want to commit yourself to so many hours, so much travel, or so many days per week that you don't have a life. That's a quick way to burn out. Not only will you fail to reach your goals, you'll be discouraged and may even think you can't reach your goals or that budgeting doesn't work.

- **Long-term need:** To earn extra income for a long-term need, such as retirement, consider the same things you did for a mid-term need. Recognize that the decisions you make will affect your lifestyle for a long time.

If you're going to be forced to spend more time at work, have more commuting costs, or have wasted "dead" time (blocks of time between jobs that are long enough to be annoying but short enough you can't really use them for naps, grocery shopping, or whatever), it may be time to consider cutting back on your lifestyle. Moving to less expensive housing, sharing housing, seeking sales, bartering more aggressively, and so on, will allow you to make more life-enhancing decisions sooner.

For mid-term or long-term extra income needs, consider trading some of the income for cutting back on your lifestyle. The tips in this chapter can help you make your money go farther so you can enjoy your life and still get out of debt and start a savings program.

Book II

Money Management Basics

The 5th Wave By Rich Tennant

"I just don't know where the money's going."

Contents at a Glance

Chapter 1: Getting Credit (Where Credit Is Due) 61

Chapter 2: Getting Into Debt 69

Chapter 3: Getting Out of Debt 85

Chapter 4: Budgeting and Record Keeping 113

Chapter 5: Planning for the Inevitable: Taxes 137

Chapter 1

Getting Credit (Where Credit Is Due)

In This Chapter

- Examining the pros and cons of credit
- Determining acceptable levels of credit debt
- Comparing paying cash with using credit

You may remember your first credit card as a badge of adulthood. At university campuses from Vancouver to Halifax, students are enticed by offers of credit cards. You may get mail from banks almost weekly offering pre-approved credit and competitive rates. If you don't have a bad credit history, banks and credit unions are more than willing to extend you some credit.

Getting a credit card is one thing. Using it effectively is another story altogether. And that's the very important story of this chapter.

The Pros and Cons of Credit

Securing credit is applying for a loan: You ask a financial institution to lend, or "rent," you the use of its money. For the use of the money, you can expect to pay "extra" money. The terms of your agreement specify the rate of interest — the extra money you pay in order to pay back your debt to the institution that issued the credit card.

The benefits of establishing credit are significant. They include the following:

- The ability to make major purchases when you don't have immediate cash for the item(s)
- A sense of security that you can handle an unexpected emergency by using credit

- The convenience of shopping without carrying a lot of cash
- Monthly itemized credit statements that enable you to track your purchases
- Worldwide acceptance

Establishing credit is a double-edged sword. With its benefits come some major disadvantages, including the following:

- Easily available credit can make spending just as easily second nature.
- If you can't pay off your credit balances on time, you hurt your credit rating.
- You can fall into the trap of paying off only some of the credit debt instead of paying the whole amount when it is due.
- When you add credit expenses to the stated price, you end up paying more than you expected. Sometimes you pay more than double!

For many Canadians, over-aggressive use of available credit can result in a debt load that is very difficult to sustain.

Establishing Credit for the First Time

When you're fresh out of school, starting over after a divorce, or emerging from bad debt or bankruptcy, your thoughts turn to establishing or re-establishing credit. Here are some tips for establishing credit and getting off to a good start in managing credit debt:

- Open a chequing account and a savings account at a local or online bank or credit union. Keep your balance at the acceptable minimum level, and never overdraw your account.
- Make an appointment with your personal banker to apply for a bank credit card. Come prepared with a statement of your personal assets and liabilities and your monthly budget, along with your Canada Revenue Agency (CRA) assessment for the past two to three years.
- Apply for a charge account at a local store. Shop at this store and charge your items. Pay your bills promptly — these cards usually have obscenely high interest rates.
- Ask a parent or mentor to co-sign for a credit card issued in your name. With this arrangement, you have personal responsibility for payments, and your credit history will be reported in your name. The co-signer agrees to take on the liability for payments if you can't pay.

- Keep trying. You may be rejected for one credit card and then be granted another, especially after you establish your creditworthiness by opening bank accounts and successfully using bank cards and store charge cards.

Deciding on an Acceptable Level of Credit

When the credit card offers start coming, you'll notice they seem to compete with each other by raising the level of credit they will extend to you. You may get a small thrill when you receive a letter from a credit card company telling you you're prequalified for a line of credit that boggles your mind.

These days, companies are offering $10,000, $25,000, and even up to $100,000 lines of credit. This is absurd! Why would anyone want that much credit card debt? You may be flattered to think that someone would extend you a line of credit for large amounts of money, and you may be tempted to say, "You never know when that money would come in handy." Don't give in to temptation — you need to think seriously about the level of credit debt your income can tolerate. Just because a lender is willing to extend that line of credit doesn't mean you have to use it. Still, the temptation to do so is great, and many fall into the trap of using their line of credit to the maximum.

Imagine Mr. and Mrs. Conservative — the couple who pay cash for everything and don't owe anyone money. Their debts are paid. Their cars and house are paid for. Their children went to university and are now buying houses of their own. Yes, they borrowed money, but only to buy their home, and then they paid off the mortgage ahead of time. These two certainly weren't victims of the recent North American credit crisis, spawned by cheap interest rates on mortgages that had no business being written!

Now, imagine Mr. and Mrs. Bigspender — the couple you like to be with because they always pick up the tab for dinner. They talk about the expensive vacations they take and the fancy cars they drive. They live in a large home and have a cottage. They're up to their eyeballs in debt. They have no clue about how to change their spending and debt habits. Who's really having all the fun?

Your own comfort with credit card debt is likely to be somewhere in the middle. The following tables can help you figure out what your level of debt should be.

First, use Table 1-1 to identify the amount of debt you currently carry. The first two lines of the table are examples; fill in your own debts in the remaining lines. (Feel free to add lines if you need to.)

Table 1-1 Monitoring Your Debts and Monthly Payments

Creditor's Name	*Loan*	*Total Due*	*Monthly*	*Maturity Payment*
Main St. Bank	Car	$5,040	$140	36 months
Visa		$1,000	$120	10 months
_____	_____	_____	_____	
_____	_____	_____	_____	
_____	_____	_____	_____	
Total debt				_____
Total monthly payments				_____

Most financial advisers recommend a personal debt limit of between 10 and 20 percent of your net income, maximum. To figure out your personal debt ratio, use Table 1-2.

Table 1-2 Determining Your Debt Ratio

Your monthly net income	_____
To accommodate debt of 20 percent, divide your net income by 5.	_____
To accommodate debt of 15 percent, divide your net income by 6.7.	_____
To accommodate debt of 10 percent, divide your net income by 10.	_____
Your monthly debt obligations (see the "Total monthly payments" line in Table 1-1)	_____
Calculate your debt margin (the ratio of debt to net income) by subtracting your monthly debt obligations from whichever level of debt you're comfortable with	_____
Figure out your personal debt ratio by dividing your monthly debt obligations by your monthly net income	_____

Table 1-2 applies simple math to help you determine the level of credit that's acceptable to you with your net income. If your debt margin is too close for comfort, sit down right now and write down three ways you can reduce your monthly credit-instalment payments. If your debt margin is comfortably less than your monthly credit obligations, don't rush out to buy things on credit. Instead, congratulate yourself on your frugality and revisit your savings plan (see Chapter 4 in Book I).

Avoiding the Credit Card Trap with the Two-Card System

Many financial advisers will tell you never to take your credit cards out of the house. As soon as you do, their easy availability makes frivolous purchases easier and more tempting.

For many people, the stack of plastic in their wallet gives them a sense of security and pleasure. The greater the number of credit cards, however, the greater the danger of overspending. To avoid costly credit card abuse, consider the two-card system, described in the following sections.

Finding a good card

Selecting a credit card that works best for you is often as difficult as establishing credit in the first place. You have so many choices — most financial institutions offer co-branded Visa or MasterCard cards. In general, though, credit cards vary in at least four aspects:

- **Annual fees:** Some cards charge an annual fee ranging from $25 to $75. Some cards waive the annual fee for first-time customers but charge the fee in subsequent years after the customer has become accustomed to using the card. But other cards do not charge an annual fee. Look for these no-fee cards, which have become more prevalent in recent years.
- **Interest rates:** Rates vary, generally ranging from 7.5 percent to 19 percent — and skyrocketing up to 25 percent on cash advances! It pays to shop around aggressively and compare interest rates.
- **Grace periods:** Some cards begin to charge interest from the date of each purchase; others begin to charge interest from the date of expected payment. Again, shop around to find a card that offers a longer grace period. In fact, reject outright those cards that charge immediate interest from the date of purchase.

- **Co-branding:** More and more credit cards are partnering with airlines, gasoline companies, and financial institutions to give customers incentives to use their cards. Some cards give frequent flyer miles on a particular airline for the dollar value of purchases made with the card. Others offer free gasoline or discounts on purchases. This type of card may be advantageous to you, but weigh the interest rates and annual fees against the benefits. Many experts agree that in almost every case the total cost to you far outweighs the reward.

Using the two-card system

After you compare cards, select two that serve your needs and refuse or cancel all the rest. Determine to use one card with the lower interest rate for large purchases, because you probably cannot pay off the balance in one month, and the other, with the higher interest rate, for smaller purchases, because you will pay off this balance each month.

The two-card system works best when you know you'll be making a major purchase. Perhaps you know you need a refrigerator, or you want a better sound system. These are big-ticket items, and you probably don't have ready cash available for the purchase.

Become familiar with the timing of the billing for your large-purchases credit card and time your major purchases accordingly. For example, if you make a purchase immediately after the billing date and you have a grace period of 25 to 30 days, you have, in effect, free credit for almost two months. If you buy that refrigerator on February 2, the day after your billing date, the purchase will not appear on your bill until March 1. You often have 30 days to pay without interest. If you pay the entire bill on April 1, you will not have paid any interest for that purchase.

If a finance charge is calculated on the average daily balance with newly purchased items included, finance charges are immediately added to your bill. In this case it's better to pay the bill as soon as you get it, because the charges add up daily.

Use the second credit card for your smaller purchases. Pay the amount due on this credit card in full each month. Limit your spending to accommodate those purchases you can pay off entirely and those larger purchases you can manage while still maintaining the comfortable debt ratio you identified in this chapter.

Understanding the Cost of Credit

Credit costs you money. For example, if you use your credit card to buy a $120 watch as a Christmas gift, here's how the costs add up: First, add in the provincial sales tax (PST) and goods and services tax (GST) (some provinces have a harmonized sales tax — HST). Then add in the finance charge. This charge, in its common usage, means the combination of the interest rate and any transaction fee the credit company adds to single or cumulative transactions. If your finance charge is 19.2 percent and you pay $10 a month for a year to pay for the watch, your watch costs $120, plus PST and GST (or HST), plus about $15 in credit charges. All of a sudden, that watch seems a lot more expensive.

If you leave part of your bill unpaid, the creditor will charge you interest. The creditor also assesses a transaction charge for the service of extending credit to you. The entire finance charge is taken from your payment, and your debt is reduced only by what's left over. For example, if you make a partial payment of $50 and the finance charge is $10, your debt is reduced not by $50 but by $40. Partial payments reduce your debt very slowly.

Recognize signs of trouble

The more you buy on credit, the more you pay to reduce your debt. You know you're in credit trouble if you recognize any of the following warning signs:

- You find yourself charging more and more and paying with cash less and less.
- You let some bills slide and postpone payment for a month.
- You make partial payments instead of paying the entire bill.
- Your debt-to-net-income ratio exceeds 20 percent.
- You take out new credit cards to cover additional purchases after you max out the cards you're currently using.

Cut credit costs

Only you can control what you buy on credit. Credit cards that get out of control cost you money and delay your ability to invest in your financial future. Try the following tips to reduce your credit costs:

- Shop for a low-cost or free credit card.
- Don't pay extra annual fees for premier cards that offer gold or platinum benefits unless you really need the extra benefits. Don't pay for services you won't use, no matter how neatly packaged the offer.
- Use your credit cards only for necessary purchases. Don't charge toys, liquor, or vacations. If you can't pay cash, you don't need them at the moment.
- If you're making a major purchase on a credit card, select a card that charges a lower interest rate.
- Review your credit card statements carefully each month. Attend to mistakes or questions about your bill promptly.
- Pay the entire bill on every credit card every month.
- Reduce the amount of credit available to you. Cancel credit cards you don't need.
- Consolidate your credit card debt so that you pay interest charges on only one card.
- Pay off outstanding credit card balances before taking on further debt. Re-evaluate the amount of debt you're willing to carry in relation to the amount of money you want to save.
- Pay off the credit cards with the highest interest rates first.

Chapter 2

Getting Into Debt

In This Chapter

- Defining credit, debt, and expenses
- Figuring out how much you owe
- Determining how you got into debt
- Setting your priorities
- Looking at the resources or assets you have for reducing your debt

Knowing the different types of debts and expenses that drain the money out of your pocket every month can help you prioritize your payments and identify places to cut back. This knowledge also helps you assess how effective your choices are likely to be; some of the available options may or may not help, depending on the type of debt you have.

Understanding Debts and Expenses

Debt is anything you owe. Debt can be very short term, like ordering a meal in a restaurant and having to pay for it before you leave, or long term, like buying a house with a 30-year mortgage. Whatever you have to pay is a debt. But to understand debt's impact on your financial future, you need to understand credit. This Book deals only with personal credit, which has two aspects: having funds put at your disposal (loan, cash advance); and time given for payment of goods and services sold on trust (credit cards, instalment plans). Both involve your written, contracted promise of future repayment, almost always with interest.

Credit

The way you get credit is by establishing creditworthiness, which is a measure of your reliability to repay a loan. Lenders consider three factors in determining creditworthiness:

- **Capacity:** The measure of your ability to repay; refers primarily to your income and the duration of your employment.
- **Capital:** The value of what you own, including property, vehicles, investments, and savings.
- **Character:** Generally regarded as the most important factor. To determine this, lenders rely only on reports of your credit history. Remember, computers don't care about the firmness of your handshake.

Credit bureaus collect information on the borrowing and repayment patterns of all consumers. They put everything about you that may affect repayment — including the name of your employer, income, mortgage, outstanding bills, legal problems, available credit — into this history. Credit reports that are sent to potential lenders, and which can be requested by employers when you apply for jobs, are based on your credit history.

The reason why credit histories suffer so badly when you don't pay your bills is that credit is not merely a convenience, it is a legal contract built on a foundation of trust. In failing to pay bills, you are both breaking the law and betraying trust. Most consumers don't think of credit this way — but creditors do. You may want to think about how you view credit, because it really affects how you use it.

You can research your credit history on your own. You can purchase a copy of your up-to-date credit history from companies such as Equifax (`www.equifax.ca`) — the same resource creditors use to evaluate your credit history. On the Equifax home page, click the Equifax Credit Report icon to get credit histories.

Debt

The "Assessing Your Situation" section in this chapter provides guidelines to help you determine whether your debt is enough to worry about. However, any debt is too much if you're not completely comfortable with it. If you can't easily pay all your bills every month, or if you carry a balance on any of your credit cards, you're already wading into the bog. If you don't do something to change your direction, you'll be in over your head before you know it.

Debts are broken down into a variety of categories. Understanding and identifying these categories can help you prioritize your payments and identify places to cut back. All debts are either secured or unsecured.

Secured loans

A *secured loan* is a loan backed by collateral — something of value that you own, and pledge to a lender to insure payment. You make a promise, usually in the form of a printed security agreement, stating that the creditor, or person or company you owe money to, can take a specified item of your property if you fail to pay back the loan.

Often, the item pledged is the one being purchased. The pledged item can also be an item you already own. If you stop paying for any reason, the pledged item goes to the creditor.

The most common items purchased by a secured loan are:

- Houses, condos, land, and cottages
- Motor vehicles (cars, trucks, vans, and motorcycles)
- Major appliances and electronics (refrigerators, washing machines, televisions, and computers)
- Furniture and power tools
- Valuable jewellery
- Stocks, bonds, and mutual funds

Generally speaking, secured loans are high priorities in your debt repayment plan, especially if the loans are for a home or transportation. You may be willing to have someone repossess a diamond necklace, but you certainly don't want anyone foreclosing on your mortgage and repossessing your home.

Unsecured loans

An *unsecured loan* is a loan not backed by collateral — anything you own that can be taken by the lender if you can't pay the debt. The majority of debt in Canada is in the form of unsecured loans — primarily credit cards — but this category also includes student and personal loans, and dental bills. (Personal loans are unsecured loans that you take out to pay for specific expenditures, such as a vacation, a wedding, or a major appliance.) The lender grants you credit based on your creditworthiness or, in some cases, on the creditworthiness of a co-signer (someone who agrees to repay the loan if you are unable to).

Because unsecured loans are riskier for lenders, most of these loans have higher interest rates than secured loans do. Due to high interest rates, particularly on credit cards, these loans can represent the biggest drain on your finances.

Expenses

Expense is spending or cost — just another form of debt, really. But expense is traditionally short term, like food costs or the phone bill. (Of course, putting expenses on a credit card makes them part of your "real" debts, with the increased possibility of added interest payments.)

Many sources use the terms *expense* and *debt* interchangeably, so understand that whichever term is used it always ends up meaning money is going out.

Essential expenses

Some expenses must be paid, either because of the law or because you still need someplace to live — even if you're broke. These essential expenses are divided into two categories: essential fixed expenses and essential variable expenses.

Essential fixed expenses don't vary from month to month. You may see annual increases in some categories, but you can often anticipate these expenses and plan for them. Essential fixed expenses include the following:

- Rent or mortgage payments
- Car payments
- Insurance (auto, health, life)
- Alimony/child support
- Taxes

Essential variable expenses differ from month to month, but they often offer you a greater opportunity to cut costs, either by finding less expensive alternatives or by cutting back on use. Essential variable expenses include the following:

- Food
- Utilities (water, gas, electricity)
- Phone
- Gasoline or other transportation costs
- Health care expenses
- More taxes!

Other payments, such as debt repayment, are not normally included under essential expenses because these payments are not considered part of an

"ideal" budget. They include payments on secured loans (other than home equity or improvement loans and mortgage), unsecured loans, student loans, personal loans, and instalment payment plans.

Because your goal is to be debt-free and have a beautifully unblemished credit report, you want to keep repaying your debts.

Now's the time for a few words about an essential expense: taxes. Most of the time, adequate taxes are deducted from your paycheque. But if you find at the end of the year that you owe taxes, the expense can add to your debt burden. Of course, if you're self-employed, the expense may become a problem even before the end of the tax year. Either way, you need to keep a few things in mind when you're trying to prioritize your payments:

- Paying taxes is always and unequivocally essential, if for no other reason than it's the law. More than almost anyone else, the Canada Revenue Agency (CRA) can make your life complicated.
- That said, know the CRA wants to help you pay your taxes. The CRA offers a number of useful taxpayer information publications, and can refer you to free tax services. Also, the CRA can help you put together a payment schedule for paying your taxes.

Nonessential expenses

Just about everything that's not listed in the "Essential expenses" section is nonessential. Some services, conveniences, and luxuries have become such a normal part of everyday life you may think they're essential, but they're not.

Popular nonessentials include:

- Cable TV, especially pay-per-view
- Lawn services
- Cleaning services
- Magazine subscriptions (unless they're business related)
- Cigarettes, alcohol, and lattes
- Restaurant meals
- Movies (especially full-priced ones) and sporting events
- Non-basic cell phone plans
- Expensive hairstyling
- Designer clothes
- Club memberships

Borderline/debatable expenses

Just as one person's meat is another person's poison, so, too, one person's nonessential expense can be another person's necessity. Because no one else possesses precisely the same combination of characteristics, needs, priorities, and circumstances that you do, some expenses — perhaps many — require careful consideration. Be honest with yourself about what you really need, and what you simply are accustomed to or find convenient.

An expense is considered borderline or debatable when, due to circumstances or life situation, it cannot easily be dropped into either the essential or the nonessential category. Borderline expenses may be nonessential in themselves, but you may be nearly finished paying for something with no hope of regaining your investment. They may be debts owed to people you can talk into waiting a little while longer for repayment. Also, some essential expenses (such as a phone) have extra features (such as three-way calling) that are nonessential in most cases.

Following are examples of expenses that may be borderline or debatable:

- If you're young and healthy, permanent life insurance is debatable. Consider term life insurance until you're out of debt.
- Health club membership may be debatable. If you just signed up and owe thousands, dump the membership. If you paid a huge, nonrefundable initiation fee several years ago and pay only a small monthly or annual maintenance fee now, the membership is probably worth keeping — especially if you use the health club as a low-cost alternative to costlier activities.
- Health and auto insurance may be essential, but low deductibles aren't. Find out whether you can lower your payments by having a higher deductible. However, make sure to budget for extra savings to cover the higher deductible.
- Clothes are less debatable than you may think. For most people (other than growing children), clothes don't need to be replaced that often. Consider sticking with what you have for a couple of years unless something disintegrates or you have to go on a job interview and you don't have anything appropriate to wear.

Identifying your expense types

To identify how your expenses and debts can be categorized, write down everything on which you spend money. Include as much detail as possible in your list, making the list as long as necessary.

Although big purchases obviously cause greater debt, the little, unplanned things — the ones you hardly even notice — are often the ones that undercut your best intentions. For example, snacking out of vending machines combined with stopping for gourmet coffee on the way to work each day can add up to nearly $2,000 a year — and that's after-tax money, so you have to earn $3,000 before you have $6 to blow each day on a luxury treat.

Using the following codes, identify the status of each expense item on your list:

- S = Secured loan
- U = Unsecured loan
- EF = Essential fixed expense
- EV = Essential variable expense
- N = Nonessential expense
- R = Expense that can be reduced
- C = Expense that can be cut entirely
- ? = Need to research whether this expense can be reduced or cut

Note: You don't see a code for borderline/debatable items because items are borderline only until you decide which category they belong in. Making that decision is one of the things you need to accomplish in this exercise.

Table 2-1 gives you an idea of how your worksheet may look.

Table 2-1 Items on Which You Spend Money

Item	*Category*
Mortgage	S, EF, ?
Food	EV, R
Phone, general	EV, R
Phone, extras	
Entertainment	
Magazines	
Gasoline	
Health club	
Beverages purchased at/to/from office	
Car payment	
Life insurance	
Personal loan(s)	
Cigarettes	
Cable TV	

Continue to add lines, making the list as long as necessary. You want to account for everything on which you spend money.

This chart is not a contract. Expenses do not need to remain static. As circumstances change, you can add or delete items or change the status of an item. If a job change makes it necessary for you to have a pager, for example, you can simply move that expense from the nonessential to the essential category.

For the next few days, you may want to keep a notebook and jot down items you didn't think to add to your expense list. (Those items could include the toll you always pay on the way to work, the laundry money you always toss in a jar so you'll have it when you need it, or the drink you have with friends every Friday night.) The more aware you are of where your money goes, the easier it will be to keep your expenses under control.

By the time you're through with this worksheet, you have a pretty good idea of where your money is going, what you must include in your budget, and where you can cut back.

You can reduce most expenses if you put your mind to it. The more you reduce expenses, the more quickly you can improve your credit history.

Assessing Your Situation

One thing is true for everyone: To plan how to get somewhere, you have to know where you're starting. That's why you need to start by assessing your financial situation.

How you got into debt is particularly significant because the work you need to do and the changes you want to make will be different if, for example, your debts were caused by job loss as opposed to uncontrolled spending. Determining your priorities will help you later in the budgeting and rebuilding process.

Figuring out how much you owe

You can set your repayment priorities later. Right now, you need to figure out where you stand in the negative column.

Total debt

Use Table 2-2 to record all your debts. Total your debts by type, and then calculate your grand total. This final number represents your total outstanding

debt. If an item in the sample worksheet doesn't apply to you, skip it; also feel free to add or delete items so the worksheet accurately reflects your debt. Also, add the percentage interest rate being charged for each credit card and loan next to the amount due.

Table 2-2 Calculating Your Total Debt

Home Debt	***Amount Due***	***Annual Interest Rate %***
Mortgage	$_____	_____ %
Home equity loan	$_____	_____ %
Furniture on instalment plan	$_____	_____ %
Appliances on instalment plan	$_____	_____ %
Past-due utility bills	$_____	_____ %
Total home debt	**$**_____	
Auto Debt	***Amount Due***	***Annual Interest Rate %***
Loan/car 1	$_____	_____
Loan/car 2	$_____	_____
Total auto debt	**$**_____	
Credit Card Debt	***Amount Due***	***Annual Interest Rate %***
MasterCard	$_____	_____ %
Visa	$_____	_____ %
Other	$_____	_____ %
(Add as many other lines as necessary)		
Total credit card debt	**$**_____	
Miscellaneous Debt	***Amount Due***	***Annual Interest Rate %***
Health care bills	$_____	_____ %
Personal loans	$_____	_____ %
Student loans	$_____	_____ %
Other loans	$_____	_____ %
Total miscellaneous debt	**$**_____	

(continued)

Table 2-2 *(continued)*

Outstanding Taxes	*Amount Due*	*Annual Interest Rate %*
Federal	$_____	_____ %
Provincial	$_____	_____ %
Municipal	$_____	_____ %
Other	$_____	_____ %
Total tax debt	**$**_____	
Total all debts	**$**_____	

Notice you don't have to include regular expenses such as utilities (unless they're past due), food, and fuel. That's because, even though these expenses arise regularly, they really aren't part of your debt (unless you charge them). However, they do have an impact on how much money is available to go toward your debts. So don't get rid of any information you have on these expenses, because you'll need it when you do your budget. (See Chapter 3.)

Rent and lease payments are also excluded, because they are not debt in the same sense a loan is — though you are legally obligated to pay both even if you give up the apartment or car. Also, alimony and child support are not included. Although these are all debt obligations if you owe them, and have to be part of your calculations, they are not things you can pay off early or reduce.

Debt as percentage of income

To determine how serious your debt is, you need to determine how much of your monthly net income (that's income after taxes — your actual take-home pay) is going toward paying debt. To do so, follow these steps:

1. Add up your monthly debt obligations, including rent or mortgage payment, lease or car loan payments, other loan payments, credit card payments, alimony, and child support.
2. Divide the total by the amount of your monthly income after taxes. Unlike the total debt amount you calculated earlier, for this calculation consider only the monthly payments you make.

For example, imagine you have a mortgage payment of $800, an automobile loan payment of $300, a credit card payment of $100, a student loan payment of $200, an instalment loan payment of $100, and take-home pay of $4,500.

Here's how this monthly debt obligation translates into debt as percentage of income:

$800 + $300 + $100 + $200 + $100 = $1,500 in monthly debt obligations

$1,500 ÷ $4,500 = 33.3 percent

In other words, 33.3 percent of the monthly net income ($4,500) goes toward paying off debt.

If your debt obligations are 25 percent or less of your take-home pay, you're in reasonable shape. If they're between 25 and 35 percent, you should be concerned and begin thinking about how you can try to get closer to 25 percent or less. If they're over 35 percent, you're headed for serious trouble or may already be there — you must move quickly and decisively to reduce debt.

The 33.3 percent in the sample formula, therefore, is not yet catastrophic but is well into the "time to get serious about debt" range.

On a card or piece of notepaper, write your current percentage, then write next to it the percentage to aim for (25 percent or less). Write today's date on the card, and write down how long you think it will take you to achieve your goals. (Don't worry, you can always revise this estimate as you progress.) Place it somewhere you can see it regularly, to help you keep your goal in mind.

How did you get into debt?

It's possible you played no part in the accumulation of debt — you may have inherited it from others or acquired it as a result of circumstances beyond your control, such as a serious illness, an accident, or a natural disaster. In that case, you simply need to address the mechanics of paying bills and rebuilding credit. With the disciplines of a few money-saving and debt-retiring strategies, you may find yourself in a stronger position than before your debts accrued.

Most people, however, have a pattern of debt — a series of behaviours that get them into the hole. The more uncertain you are of how you got into trouble, the more likely it is you'll need to change some of your behaviours. If you're not as debt-averse as you should be, recognizing this as a risk factor is the first step to getting yourself fiscally fit!

This important exercise will help you determine how you got into debt. You need to be really honest with yourself for this to work. If you've run up thousands of dollars in credit card debt, don't call it "bad luck." Get a sheet of paper and start to write down behaviours or triggers that get you into trouble. Don't judge yourself or your debts as you write. No one else needs to see this list. Simply write down everything that's fuelling your debt.

To get started on your list, answer the following questions:

- Why did you take on your first significant debt load?
- How do you feel about debt?
- How does spending money make you feel?
- Do you ever "binge shop"? If so, what sorts of things trigger the binges?
- What reaction do you have to advertisements for items you want but can't afford?
- Do you believe that paying the minimum amount on your credit card will get the balance paid off?
- Are you ever surprised by how high a bill is?
- Do you forget about money you've spent?
- Do you balance your chequing account regularly?
- Do you have any expensive hobbies or habits?
- Do you feel competitive with or threatened by those around you?
- How often do you eat out?
- When you eat out with friends, do you collect cash from others, charge the meal, and then buy something else with the cash instead of paying down your credit card debt?
- Do you plan your purchases or do you buy on impulse?

Review your list on how much you owe. The information may give you even more ideas about how you got into debt. Add any discoveries to your list of trouble behaviours and triggers.

As you write, more ideas may come to you. Record everything that crosses your mind regarding your spending habits, whether it's a feeling that you must pamper yourself to deal with stress, a hope that you can overcome your sense of dissatisfaction with life, or a belief that you need to impress someone.

A journal can be particularly helpful in identifying emotion-triggered spending, as well as in tracking your progress and recording what you learn, both about the process and about yourself.

As you continue through the rest of this book, add to your list any new information you discover about yourself. Knowing why you spend and what your triggers are can help you figure out how to stop uncontrolled spending.

Determining your priorities

Obviously, one major priority is to get out of debt. At this point, however, you need to think about what your priorities in life are; how they relate to or may be affected by debt; and how they fit into the process of getting out of debt.

For this exercise, think about your real priorities — the things that matter deeply to you. You need to account for considerations like family and beliefs first and foremost, no matter what type of debt you're facing.

Later, when you start to create your budget, you can prioritize your "wish list" — the things you would like but that aren't really vital in the greater scheme of things — in order to identify expenses you can reduce or cut. But right now, think about the priorities that will help you determine what kind of path you will take.

Here are some questions to answer as you think about your priorities:

- Where does your family fit into the picture?
- Is taking a second job an option (financially, emotionally)?
- Is giving to charity or religious organizations important to you?
- For your own peace of mind, how quickly do you want to be out of debt? What are you willing to sacrifice to get there?
- What things that are important to you are affected by your debt, or may be affected by it if you do not remedy it? (This may include anything from not being able to join friends for dinner to having to postpone starting a family or losing your house.)
- What goals do you have that may be attainable when you're out of debt? (This could be anything from educating children to enjoying a comfortable retirement.)

As you think about your priorities, jot down the things that matter most to you — the things that will have an impact on how and why you want to get out of debt.

If you have young children or aging parents, you may not view a second job as an option. In this case, you're making family a priority and accepting the possibility of a slightly longer repayment period. The debts aren't going anywhere but the people are, so this is a good choice.

Getting in or out of debt is about making your life better, not worse.

Looking at your resources and assets

In evaluating the resources and assets you have for getting yourself out of debt, consider not only your income but also any capital available, including savings, investments, and property. This exercise has two steps:

1. **Calculate your monthly income.**

   You'll use this figure later to work out your budget. Because income can change over time, the wisest approach is simply to figure out what you're taking in at the present time.

2. **Determine any additional funds that may be available to you.**

   If you need to make dramatic changes in your debt profile, also consider potential sources of money.

Set up your calculations something like Table 2-3, with the various real or potential sources of funds separated.

Table 2-3 Calculating Your Total Assets

Income (After Taxes)	***Amount***
Primary wages	$_____
Secondary wages (second job/secondary wage earner)	$_____
Alimony/Child support	$_____
Government support	$_____
Other income	$_____
Total income	**$**_____
Easily Accessible Money	***Amount***
Savings	$_____
Investments	$_____
Total easily accessible money	**$**_____
Less Accessible Money	***Amount***
Home equity	$_____
Car equity	$_____
Boat equity	$_____
Other (such as equity in a vacation home or undeveloped property)	$_____
Cash-value insurance	$_____

Total less accessible money	**$**_____
Other Possible (Though Less Desirable) Sources of Money	***Amount***
RRSPs	$_____
Total other sources of money	**$**_____

Reviewing your assets helps you determine where your money is, which in turn helps you with both the budgeting process and improving your debt picture (see Chapter 3).

Chapter 3

Getting Out of Debt

In This Chapter

- Creating a budget that manages your debt
- Keeping up with your minimum payments
- Paying down your debts
- Finding more money in your budget
- Deciding whether bankruptcy is appropriate for you

Your first step to managing your money is to figure out your goals and to assess the debt that might prevent you from achieving those goals. In Chapter 2, you determined where you are in terms of your goals and your debt — your starting point. Your goals are about where you're going. Now it's time to plan the trip. This process includes setting specific debt management goals, determining how long the journey should take, and creating a map to help you get there.

Putting Together a Budget

This map is your budget, which helps you do two things: plan your spending and track your progress. A budget may seem restrictive at first, but it frees you from the worry of not knowing how you're doing financially. A budget can give you greater control and keep you on the road to your destination — freedom from debt. Budgets are great vehicles to help you get where you want to be, but they require a special fuel — your commitment!

Determining and refining your debt repayment goals

Setting goals takes effort and commitment. You'll need to think carefully about where you want to be financially, as well as what future plans you have that may be affected by your finances. You'll also need to be reasonable, and

not set yourself impossible goals. Take this seriously, but don't panic about it — you can modify your goals as time goes by. It's not meant to be a nasty straitjacket.

The following sections discuss the key elements you will need to consider to create goals that are both attainable and motivating.

Be positive

Your goal shouldn't be something negative, such as: "To spend less money." Staying motivated by a negative goal is difficult. Charting your progress is also difficult — when have you cut enough? To be effective, your goal needs to be an accomplishment, not a sacrifice.

Instead, your goal should be something like: "To enjoy the freedom of carrying a debt load of only 25 percent of my take-home pay." That goal is positive and quantifiable. Other possibilities may be: "To pick up the mail without being nervous," "To feel I am in control of my finances," or "To get to a point where I can start investing so that more money is coming in than going out." These goals aren't as easily quantifiable as the percentage-of-take-home-pay goal, but the point is to find something that keeps you motivated and excited about the process.

Take your plans into account

In a way, you've already established one goal: to be out of debt. Although this is your primary goal, you may want to consider other, secondary goals, which will be made possible by your success with your primary goal.

Depending on where you are in life, your plans may be to have children, put children through university, buy a house, or enjoy a secure retirement. All these goals will benefit — and some are only possible — if you get your finances under control. The nearer in time your plans lie, the more quickly you want to eliminate your debt and begin saving. For example, if you want to buy a house in five years, you may be willing to work harder to pay off your credit cards so you can get a mortgage. And you may even want to give yourself an extra year or two to save up for furniture so you don't get into too much debt again.

Over time, your lifestyle, earning power, and attitudes may change, so review your goals regularly to make sure they still reflect your plans.

Establish a time frame

The general structure of goal-setting is to establish immediate goals, intermediate goals, and long-term goals.

- **Immediate goals** are goals that you expect to accomplish in the next few weeks, such as finishing your budget, getting started on paying debts, and making necessary adjustments to your spending.
- **Intermediate goals** are goals that need to be set at regular intervals — every six months, for example. At these intervals, you can review your accomplishments and reassess your direction. But, as always, these should also be specific goals, such as: "Pay off credit card X by this date."
- **Long-term goals** are the goals that take you to the end of your debt problems and beyond. These goals may include getting to a point where you have no credit card debt, followed by having your debt in the 25 percent range, possibly followed by paying off your mortgage and/or building future wealth.

You can always adjust the dates if you don't accomplish everything you planned by a given date — or if you're paying off debts faster than you expected. These time goals aren't carved in stone, but rather are goalposts — you try to get the ball between the posts, but it doesn't always happen. However, without goalposts, you'll never know whether you scored.

Make sure to allow yourself a realistic amount of time to get out of debt. You probably didn't get into debt overnight, and you certainly won't get out of debt overnight. Different factors can contribute to getting out of debt in more time or less, including your level of net income, your take-home pay, and your level of commitment to the process.

Write down your goals

Plenty of good reasons exist for writing down anything that's important:

- You tend to remember information better if you take the time to write it down.
- You're more likely to believe something you see written out. Seeing it on paper makes it real, concrete, and tangible.
- You have something to look at, which makes it harder to forget or ignore that you've made a decision.
- You have proof you've already accomplished an important task. Goal-setting is a major step in the process of getting out of debt, and when you've set the goal you can start getting excited about the destination.

Write out your positive, long-term goal statement at the top of a sheet of paper. Beneath it, write out the dates you've set for attaining your short-term, intermediate, and long-term goals.

If you haven't already started a file or three-ring binder for the project of getting out of debt, now is a good time to do so. Place your sheet of written goals in the front of the binder or file. This way, you have everything you need in one place: goals, worksheets, and any other information you collect.

In addition to the sheet of paper listing your goals that you put in your file or binder, you can write out your positive, long-term goal statement on a 3-x-5-inch card and post it where you'll see it regularly, such as on the bathroom mirror.

For this reminder note, you can rephrase the statement in a less formal way. For example, instead of "In five years, I want to have my debt to 25 percent of my take-home pay," you may write it as "In five years, if I stick with this, I can be free!" Write whatever gets you the most excited about this process. You can then rewrite the note every time you reach an intermediate goal ("Just four more years!"). Updating your note helps keep you out of the "Are we there yet?" syndrome that accompanies many long-term projects.

Creating a budget

Creating your budget is drawing your road map for getting out of debt. No single perfect form fits everyone's needs and circumstances, but you do need to consider some basic elements if your budget is going to work. An effective budget needs to be realistic, concise, flexible, and open.

- **Realistic:** Forcing numbers to work out on paper isn't hard, but these numbers need to work in real life.

  Even if you need to watch every penny at this point, don't make the numbers so low you have no hope of succeeding. If, as you go along, you find ways of cutting costs further, you can always change an entry.

- **Concise yet comprehensive:** You don't want your budget to have so much detail you spend your whole life keeping it updated, but you do want to include all the expenses you can identify or predict.

  You often can group several expenses into one category. Although you may need to track expenses more precisely from day to day (you may even want to carry a notebook in which to record them), you can consolidate some items in the budget (for example, coffee from the gourmet shop, candy from the office vending machine, and a litre of milk picked up on the way home can all be part of the food budget). See Chapter 1 in Book I for more tips about figuring out what you spend.

- **Flexible:** Feel free to improve the format of the budget as you continue to work with it. Add more lines if necessary, or delete lines. Change your spending estimates as needed, too. You may find you guessed too low, or you may discover ways to save money that enable you to lower an amount.

If your financial situation changes — you get married, find a new job, relocate, or have a new mouth to feed — you may want to draw up a new budget.

- **Open to all concerned, garnering everyone's cooperation and commitment:** Anyone in the household who contributes to income and/or expenditures needs to be involved in the budget discussions. In particular, those who contribute to the household income need to get in on the planning stages, budget creation, and review process. They need to buy in to the project for it to work.

  Small children may not need to be included in the planning, but they should know that something is happening, because the budget will affect them, too. If they feel they're part of the project, they may be more understanding when you can't buy things for them. In fact, small children can get excited about being involved and may want to contribute by saving their allowance, collecting pop bottles, or finding other ways to contribute to the family's success.

To establish your budget, you first want to create a master copy of the budget worksheet (see Table 3-1) with no numbers filled in. You may want to include a few blank lines in each category on the master, in case you need to add other items later. Then photocopy this master document to create budget worksheets to work on.

A dozen copies (one for each month) is a good start, because you'll want to work within a budget for at least a year. Even if you can get yourself to that magic 25 percent figure in less time, living on a budget for a year helps create a budget mindset that keeps you from falling back into the hole you just climbed out of. Some people live on a budget their entire lives because it's the only way they keep themselves out of trouble. You may not have to do so, but if it helps, it's an option.

Your worksheet also needs to be well organized and easy to read and keep updated. If working with the budget and calculating totals become difficult, you'll almost certainly give up. This process is serious, so make the effort to create a document that's easy to work with.

Although you'll personalize this worksheet to meet your own needs, some categories need to be a part of everyone's budget. Also, some organizational options may make the budget easier for you to manage. Be sure to do the following:

- Include a space after each item for estimated expense, for actual expense, and for the difference between estimated and actual.
- Divide the budget worksheet into essential and nonessential expenses (see Chapter 2). You may wish to further divide essential expenses into fixed and variable; doing so makes it easier to see where you may need to make changes to the budget or to your spending. (Chapter 2 helps

you create a list of debts and expenses that can help you accomplish this. Just check the category you indicated for each item.)

- After the total for the expense section, list your sources of income and total them.
- The final entry on the budget is the calculation of money remaining. Subtract your total expenses from your total income to determine what remains. The remainder is called your discretionary income.

Table 3-1 gives you an idea of what your budget might look like. Feel free to alter the format to meet your own needs, but be sure to include enough information to make the budget effective. And don't forget any debatable items that may not be listed below. Also, if you have regular legal or accounting expenses, don't forget to include them.

Table 3-1 Budget Worksheet for (Month) _____

Expense	*Estimated*	*Actual*	*Difference*
Essential Fixed Expenses			
Rent/mortgage	$	$	$
Housing association fees	$	$	$
Car payment	$	$	$
Car insurance	$	$	$
Life insurance	$	$	$
Homeowner's/renter's insurance	$	$	$
Property taxes	$	$	$
Alimony/child support	$	$	$
	$	$	$
	$	$	$
Essential Variable Expenses			
Home maintenance	$	$	$
Food	$	$	$
Electricity	$	$	$
Gas (utility)	$	$	$
Water	$	$	$
Phone	$	$	$

Expense	*Estimated*	*Actual*	*Difference*
Gasoline (auto)	$	$	$
Auto maintenance/repairs	$	$	$
Public transportation	$	$	$
Health care expenses	$	$	$
Child care	$	$	$
Charitable donations	$	$	$
Household goods (cleaning supplies, cooking utensils, and so on)	$	$	$
Savings	$	$	$
	$	$	$
	$	$	$
Fixed Loan Payments			
Student loan	$	$	$
Personal loan	$	$	$
Instalment loan 1	$	$	$
	$	$	$
	$	$	$
Credit Card Payments			
MasterCard 1	$	$	$
MasterCard 2	$	$	$
Visa 1	$	$	$
Visa 2	$	$	$
Department store cards	$	$	$
Gasoline cards	$	$	$
Other cards	$	$	$
Charge cards (cards that must be paid off each month)			
American Express (regular)	$	$	$
Diner's Club	$	$	$

(continued)

Table 3-1 ***(continued)***

Expense	*Estimated*	*Actual*	*Difference*
Nonessential Expenses			
Barber/beautician	$	$	$
Magazine/newspaper subscriptions	$	$	$
Gifts	$	$	$
Charitable donations	$	$	$
Cable TV	$	$	$
Club dues	$	$	$
Sports	$	$	$
Lessons/camp	$	$	$
Dining out	$	$	$
Movies	$	$	$
Hobbies	$	$	$
Cigarettes	$	$	$
Alcoholic beverages	$	$	$
Domestic help	$	$	$
Lawn services	$	$	$
	$	$	$
	$	$	$
Total Monthly Expenses	**$**	**$**	**$**
Monthly Income			
Take-home pay (after taxes)	$	$	$
Interest income	$	$	$
Alimony/child support paid to you	$	$	$
Other	$	$	$
	$	$	$
	$	$	$

Expense	*Estimated*	*Actual*	*Difference*
Total Monthly Income	**$**	**$**	**$**
Total Money Remaining			
Total Monthly Income	**$**		
Total Monthly Expenses	**–$**		
Total Money Remaining	**=$**		

Notice that on the sample budget, no blank lines appear under the loan and credit card categories. The simple reason is that you should not be adding items to these categories. If all goes as planned, you'll be eliminating debt categories, not adding them.

You can use the blank lines under the Other expense and income categories for seasonal expenses or annual bills, such as auto licences, vacations, holiday gift purchases, bonuses, and tax preparation services.

If you're self-employed, don't forget to list estimated quarterly taxes under Essential Fixed Expenses.

After you create your own budget worksheet and make copies of the blank form, plug in figures. You'll know some numbers immediately, especially the fixed expenses. (Chapter 2 has worksheets you can use to record your income and assets and where you spend your money, which will help you prepare your budget.) Be as accurate and realistic as possible when filling in amounts.

For utility prices, you can phone your local utility companies. They often can tell you precisely what your average monthly costs have been. Utility companies may also offer a payment plan where you pay the average of your annual bills every month rather than dealing with seasonal dips and rises. Averaged payments can make the budgeting process much easier.

All these figures go in the Estimated column, because it's what you're predicting your costs will be or what you think you'll be able to put toward paying off your debts. (***Note:*** For the fixed, essential expenses, for most of the year the Estimated column will match the Actual column, but they are still included because it will be easier when you total the columns.) Work in pencil so you can erase entries if necessary. Put down the minimum payment amounts for all credit cards, unless you regularly set and pay a higher amount.

Finally, with all the items in the Estimated column filled in, total your expenses and income and then figure your remaining money.

Evaluating your budget

If your Total Money Remaining figure is zero or negative, you definitely have to revise your budget. First, examine your nonessential expenses. Which ones can be reduced? Which ones can be eliminated? Keep working until you can't think of anything else to reduce. Be honest with yourself about what you can and can't give up or reduce. You really don't need a $65 haircut or cable TV, for example. To succeed, however, don't focus on what you're giving up, focus on what you're gaining: eventual economic freedom!

If you do have money remaining, you can use it to help get yourself out of debt faster, as explained in the section "Using Your Budget to Get Ahead of Your Debt" in this chapter. If cutting or reducing nonessentials isn't enough to get you into a positive situation, you may need to start examining your essential expenses. Check out "Moving Money to Improve Your Debt Picture" to discover how to "find" more money in your budget.

Staying up-to-date

Setting up your budget is just the beginning of your move to financial freedom. Keeping your budget going takes less work than setting it up, but it requires more commitment.

As the month progresses and bills come in, fill in the Actual column for each item and calculate the difference between the estimated amount and the actual amount, noting whether the difference is positive or negative.

Set aside time every month to total the preceding month's worksheet and to review (and update if necessary) your budget for the coming month. You can make seasonal adjustments in order to anticipate times when spending may be higher, or fine-tune entries as you get better at living according to a budget.

Stay up-to-date by making a commitment to the following:

- **Regularity:** Only by being systematic and by updating your records regularly can you get a good picture of your spending patterns. Being consistent helps you know where your money is going and how you're progressing. Also, if you fall behind, catching up may appear to be a discouragingly difficult task.
- **Accuracy:** You don't have to worry about every penny, but try to be as accurate as possible in recording amounts. Carrying a paper notebook or handheld computer can help you because you may not remember every trip to the pop machine, coffee cart, or vending machine — the types of expenses that can add $2 or $3 to each day's expense total.

- **Honesty:** If you're anything less than honest when figuring your budget, you're only hurting yourself. If you record less than what you spend, not only will you never have accurate records, you may never succeed in getting out of debt. Knowing your true financial picture is the only way to make a budget work.

Using Your Budget to Get Ahead of Your Debt

When you have a budget in hand, along with a picture of your debt situation, you can strategize about how best to tackle your debt. This section tells you how to get started, giving you strategies for reducing your debt and preventing yourself from getting even further into debt.

Using your discretionary income to pay off high-interest debts first

Discretionary income is the money you have left after you've paid all the bills you have to pay — the Total Money Remaining figure at the end of your budget worksheet earlier in this chapter. This money is the income that you use at your discretion for "extras," from treats to investing — unless you're in debt.

The budget you created includes items that may normally fall into the discretionary income category (movies, dining out, and so on) simply because at this stage you have to plan all your expenses. Depending on your level of debt, you may not have much discretionary income after all the items on your budget are accounted for. If you do have some money to spare, you can use it to help get yourself out of debt faster. This process helps cut down on one of the worst drains of money there is — compounding interest payments.

The single most devastating expense you have is the interest on credit cards. Most people don't realize how much they pay in interest or how much difference even the smallest changes can make. Here's an example:

> Say you have a credit card that has a balance of $1,500. If the annual interest is 21 percent (a fairly standard rate) and you make the minimum payment of 3 percent of the balance each month, repaying the total will take you more than 14 years, and you will have paid more than $1,800 in interest (for a total of $3,300).

If you pay just $5 over the minimum payment per month, you'll save more than $600 on interest and cut more than five years off the repayment time. If you pay $10 more per month, you'll cut nearly $900 and eight years off the interest and time that making only the minimum payment hits you with.

Those numbers show a pretty dramatic difference. And these figures are based on the assumption you don't spend any more after you run up the initial $1,500. If you keep adding purchases, they all figure into the interest rate.

To keep your creditors at bay, you must continue to make the minimum payment due on each card on which you owe. After you account for those expenses, any discretionary income you have left in your budget (the amount in the Total Money Remaining column back in Table 3-1) should go toward paying off the credit cards that have the highest interest rates.

If you planned your budget with more than the minimum payment going to each card with an outstanding balance, redo it so that you're paying the minimum on the cards with lower interest rates and putting the rest of your "extra" money toward paying off the highest cards. Follow these steps:

1. After you create your budget and plug in the minimum payment for each credit card, take as much of your discretionary income as possible and use it to pay down the credit card charging the highest interest.

   If you wrote the interest rates on your debt worksheet in Chapter 2, you'll be able to tell at a glance which credit card you need to target.

2. After you've paid off the credit card with the highest rate, put your discretionary income toward the credit card with the next highest rate.

3. Continue this process until you've paid off all your credit cards, continuing to put as much discretionary income as possible toward the card with the highest interest rate.

Discretionary income is, as its name implies, money you can use at your discretion. Occasionally, you may want to reserve a little more discretionary income to celebrate the holidays or enjoy a much-needed weekend away. However, until you're getting cozy with that 25 percent debt figure, you want to plow as much of your discretionary income as possible into paying off high-interest debts.

Think of paying off high-interest debts as saving your future buying power, because that's precisely what it is. Nothing eats into your financial potential like a high interest rate. Also remember that paying off debts is a very good thing to do to improve your credit rating. Your rating goes up as your debt goes down — and vice versa. As soon as you show you don't need debt, then

you can easily get some new debt — if that's a fiscal direction you wish to follow.

What you've been reading about so far is consumer debt, which is bad. What you want to have is investment debt, which is good. Yes, it's true: all debts are not created equal.

Cut up your credit cards

Here comes the hard part: As soon as you've paid off the balance on a credit card, cut up the card and close the account with a quick phone call to the credit card company.

You may not be able to take the scissors to every credit card you have (because it's nearly impossible to transact business these days without at least one major credit card), but do so with the majority of your cards. Plan to keep one or two of the major cards (Visa, MasterCard, or American Express) and get rid of everything else.

In fact, you probably should cut up all but the chosen two cards as soon as you start working on eliminating your debt. (Cutting up a card doesn't mean you erase the balance, of course, but it does prevent you from making additional purchases on the card.) Whatever you do, don't charge anything while you're still carrying a balance; it just makes the interest worse and the repayment time longer.

If you must have a charge card (which is possible if you have children, need a card for emergencies, or travel for business), consider getting a new card with no balance. Use this card only when you can't use cash or a cheque, and charge only an amount you can pay off completely when the bill arrives. Because your goal is never again to carry a balance on a credit card, you absolutely do not want to start running up another balance.

Forget your savings for the time being

While you're seriously in debt is the only time in your life anyone will tell you your nest egg is a bad idea. If you have any money in a savings account, close the account and put the money toward paying off your high-interest credit cards. Why earn 1 or 2 percent interest on a savings account, and pay tax on the interest, too, when you're paying 17 to 21 percent interest on your credit cards and getting no tax deduction?

Liquidate any other assets you have, such as GICs, stocks, bonds, mutual funds, and even collectibles, and use that money to pay down your high-interest debts as well. Nothing can earn you enough to make it worth staying in debt on a credit card that charges a 19 percent interest rate. Don't forget: For you

to have 19 percent after tax, you have to earn about 30 percent before tax. That is huge!

Only two exceptions to the "throw everything at your credit cards" plan exist:

- Hang on to enough money to cover one month's expenses (if possible), because emergencies do arise. If you can't scrape together a month's worth, at least save enough to buy food and gas and to pay for shelter (mortgage, rent).
- As long as you can still make the minimum payments on all your debts, don't cash in your RRSPs. The tax hit would probably be worse than the interest on your credit cards. Also, jeopardizing your future simply to avoid interest payments is not a wise tradeoff.

  If you're facing foreclosure, however, that's another matter. Go ahead and liquidate all your assets, including retirement accounts; you don't want to lose your home.

Paying down other debts

If you stick to your budget, you'll free yourself of credit card debt. At that point, you may still have other debts to deal with, such as auto loans, student loans, and a mortgage loan. Even if you're close to that 25 percent debt figure, you may still want to rid yourself of debt entirely.

The way to do so is simply to follow the same procedure for high-interest debt described earlier in this chapter: Continue to choose the debt with the highest interest and put as much of your discretionary income as possible toward that debt. As you pay off debts, remember to update your budget and reallocate your resources. Also make sure not to neglect other debts while you focus on the highest-interest one; you don't want to lose your car or your home by failing to make your monthly payments.

Some types of loans, such as mortgages, assess a prepayment penalty if you pay off the loan early. Make sure to read the fine print on your loan agreement before you end up costing yourself more than you're saving!

Moving Money to Improve Your Debt Picture

One thing you can do to get a slightly faster start along the path to reaching your final goal of being debt-free is to move your money to where it can do the most good. This tactic includes everything from finding ways to lower your

interest payments to locating and plugging the "leaks" in your budget that let money get away from you. This section shows you how to do all that and more.

Finding cheaper debt

In addition to paying off your high-interest debts, you may also be able to find lower-interest debts to help you get out of debt faster. The following are some sources of cheaper debt.

Lower-interest credit cards

How often do you get offers for credit cards with really low interest rates? Probably almost daily. If you've never taken advantage of these low rates (or you took advantage of them and just ran up more debt), it may be time for you to look at these offers again.

Of course, these reduced rates are usually for a limited time only, so check the offer to make sure the post–hot deal interest rate isn't higher than what you're paying now. But if the rate is the same or lower than what you're currently paying, you'll come out ahead even if you can't pay off the whole thing during the trial period.

In addition, some credit cards have a regular interest rate that's lower than the rate on the majority of cards. If you don't have a brochure for a great deal on a new credit card, you can research some of the better rates available by going online.

The Canoe Money (`money.canoe.ca`) Web site is great for finding good rates on credit cards, as well as rates on other things that may interest you. You can get information on mortgages, car loans, and lots of other personal finance info. It even has loan and interest cost calculators. Remember, if you don't have a computer or aren't currently on the Internet, most libraries offer free Internet access — so you don't need to spend a dime to view this site or others like it.

After you transfer balances from the higher-interest to the lower-interest cards, cut up the old cards, mail them back to the banks or other organizations that issued them, and close the accounts. The only potential exception is an emergency backup card with a zero balance. Otherwise, do "plastic surgery" and get rid of as many cards as possible.

Don't just throw your cards out. You need to mail the cut-up cards back to the banks or issuing organizations to get the accounts closed and off your credit report.

Credit union loans

If you belong to a credit union, find out what types of loans are available. You may be able to get a personal loan at a rate far lower than what you're paying

in credit card interest. If you've been a member in good standing for some time, you can often get a loan at a rate lower than what a bank would offer.

Mortgage refinancing

Refinancing a mortgage is advantageous because it can not only free up money for your current difficulties, but also lower your payments for the duration of the mortgage. This strategy helps you inch your monthly debt obligation closer to that desirable 25 percent figure by enabling you to use more money per month to pay down higher-interest debts.

You can start by talking to your bank. For the best mortgage rates, however, you need to shop around. Personal finance Web sites also give mortgage rate information. And the Canadian Mortgage Housing Corporation (CMHC), the Crown corporation that insures more than a third of all mortgages in Canada, can help a lot in this particular area of finance.

Also, if refinancing your mortgage would free up enough money to help you, doing so is a much better deal than taking out a home equity loan (see the following section), because home equity loans carry interest rates that are a couple of points higher than the current mortgage rate.

Even if you think you'll need a home equity loan too, refinance your mortgage before you consider the loan. You may be surprised at how much you save, and you may decide against the loan. Plus, it's harder to renegotiate your original mortgage when you have a second mortgage on the house.

Considering home equity loans

If you've been in your home for a few years, you may have built up considerable equity. Using that equity can help get you out of debt, but some potential dangers are involved. Also, always remember that a home equity loan (formerly known as a second mortgage) is sort of like "unbuying" your house, and you have to buy it back again.

Think about these pros and cons if you're considering a home equity loan:

- **Pro:** If you negotiate a good rate, the interest rates can be considerably lower than those on many other forms of debt, especially credit cards.
- **Con:** If you haven't curtailed your bad spending practices and haven't stuck to a budget, you're putting your home in jeopardy. Unless you've already demonstrated both a willingness and an ability to spend only what is necessary, don't put your home at risk. If you think that not having much to spend is a drag, think of what a drag it would be to be homeless and not have anything to spend.

If you decide you're ready for a home equity loan and feel certain you're not risking more than you want to lose, go ahead and get the loan. But get only as much as you need to cover your debts. Don't get anything extra. Starting around 2001, all too many North Americans stretched themselves thin with home equity loans and *sub-prime mortgages* (those with favourable front-end interest rates that were adjusted after two or three years to market rates). With both, if the value of the home decreased, or if personal income was diminished, people defaulted on their payments. Witness to this is the credit crisis that started in 2007. People who were in loads of debt were simply walking away from their homes if they couldn't make the payments!

Refuse to give in to the temptation to buy something else with money you may see as being there for the spending. It's not. You have to pay it back. A home equity loan is a less expensive debt than a credit card, but it's not "found money." It's plain-old debt in a different disguise.

If, on the other hand, your total available equity doesn't cover all your debts — well, we think you know what to do by now. Pay off those credit cards, the highest ones first. If you can pay down all your credit cards, decide what your next costliest debts are (perhaps a car payment or an instalment loan for a large appliance). Your best bet after paying off credit cards is probably to pay off items that can be repossessed.

Finding more money

You can look in a number of places for extra money — not all are easy, but all are worth considering.

The first thing to do is to review your nonessential expenses (discussed in Chapter 2). Scrutinize anything not related to your survival — think digital TV, those weekly laser facial treatments, those super-deluxe gourmet coffees you pick up on the way to work each morning. Then cut out those items you can live without.

You may even want to review your essential expenses and decide whether you can get by with spending less. For example, you could move into a less expensive apartment and save money each month, or you could buy food and other essentials in bulk to cut your costs.

You may think these small things won't make much of a difference, but consider this: If you have a 30-year mortgage of $100,000 at 8 percent, adding just $1 — yup, one loonie — per day to your payment can save you $27,000 in interest and cut four years off the duration of the loan. These changes may look small, but they can have a huge impact in the long run.

The following sections list some specific places to look for money. For other ways (increasing deductibles on insurance, finding cheaper sources of clothes, and so on), see the section on borderline/debatable expenses in Chapter 2. When you get into the swing of things, you'll probably think of other areas in which you can cut back or other projects you can do to save or earn money.

Reducing essential variable expenses

Learning to reduce essential variable expenses is one way that most people, even those who are not in debt, try to cut down on their monthly expenses. Getting good at this is useful even after you reach your goals.

- **Reduce your taxes:** Well, at least temporarily. If you normally get a refund from your income taxes, revisit your TD1 form (the form your employer uses to determine the correct amount of tax to withhold from your paycheques). Carefully go through the form to ensure you are claiming all the exemptions you're entitled to. You may not get a refund next year, but your take-home pay will increase. Getting 12 monthly mini-refunds now rather than one big one next spring is much better, don't you agree?
- **Get out the scissors:** Start using coupons and shopping for bargains. (However, don't drive kilometres and kilometres to save 2 cents on milk — you'll burn more in gas than you'll save.)
- **Eat up:** Never go to the grocery store hungry, because you'll tend to buy more than you intended.
- **Avoid brands:** Buy generic food and over-the-counter drugs.
- **Shop around for insurance rates:** Change automobile insurance companies, or raise your deductible, to get a lower monthly premium.
- **Layers, layers, layers:** Wear a sweater instead of turning up the heat, or open the windows instead of running the air conditioner. A few degrees of difference in temperature can make a significant difference in your heating and cooling bills (and consuming less energy is good for the planet).
- **Do it yourself:** Learn to do minor repairs and home maintenance jobs yourself.
- **If it's broke, fix it:** Repair or mend items rather than replace them.
- **Use your feet:** Walk (carpool, bike, or take public transportation) when possible to save money on gasoline.

Changing your (expensive) habits

Your habits can have a huge impact on the outflow of money. Consider these examples:

- **If you smoke, quit.** A two-pack-a-day habit, at $6 a pack, translates into $4,380 per year.
- **Stop drinking.** As with smoking, what seems like a negligible amount of money adds up swiftly.
- **"Borrow" some savings.** Head to the public library rather than purchasing books at a bookstore. In addition to books, you can check out DVDs and CDs for free.
- **Take your lunch to work.** Dining even in an inexpensive restaurant can add a couple of dollars a day to your budget. Bring your own coffee, too, unless your company supplies it for free.
- **Adjust your movie-going habits.** Go to movies only during matinee hours or after they hit the discount theatres. You can also rent videos or borrow them from the library and have a family movie night at home.

Finding miscellaneous money

You can look for, or earn, more money in a variety of other places:

- **Switch to an interest-bearing chequing account.** Even if you don't earn much in interest, any money you earn helps your situation.
- **Stop paying for chequing.** Look for a chequing account that requires a lower minimum balance for free chequing. If you switch from a bank that has a $1,500 minimum to one with a $1,000 minimum, you can instantly apply the $500 to paying off debts. Check out credit unions — they're great!
- **Hold a garage sale.** If you have items that are more valuable than the usual garage sale stuff, try selling them through the newspaper, by posting a note on the bulletin board at work, or on the Internet.
- **Get a part-time job.**
- **Tutor or consult in a field in which you excel.**
- **If you're doing good work, ask for a raise.**
- **Rethink your vacation.** Find out whether you can get vacation pay instead of taking time off. You don't want to do this with all your vacation time, because even folks who are broke need time off, but doing it for part of your vacation may help you along.
- **Rent out a spare room.**
- **Barter.** Find a friend or acquaintance who will babysit your kids in return for your mowing their lawn, or vice versa. Find someone who will fix your car in exchange for your cooking dinner, or who'll lend you videos in exchange for books, or who'll drive you to work if you teach him or her how to use a computer. You get the idea. The possibilities are almost limitless.

Cutting to the quick

If you've cut back everything else and you still can't make ends meet, you may have to do something about your essential expenses. Consider the following ideas:

- **If you have two cars, sell one.** Take public transportation or carpool. If you must have two cars, see whether you can downgrade — get a vehicle with lower payments.
- **Revisit your housing situation.** If your financial situation is really bad, consider selling your house and buying either a smaller house or a condo. Remember, it's better to sell your home than to have it taken away, because then you have nothing. This suggestion applies only if you have cut all nonessential expenses and still can't make your monthly payments.
- **Adjust your alimony payments.** If you're paying alimony or child support to a former spouse who is doing better than you are financially, you may be able to apply for a reduction in those payments.

Some of these measures may seem drastic, but they're not nearly as drastic, or as potentially damaging, as bankruptcy (which you can read more about in the next section). The measures in this section may inconvenience you, but they're not designed to destroy your credit history or seriously impair your lifestyle, as bankruptcy can.

Talking to your family

As a last resort, turn to your family for financial assistance. Do you have relatives who could lend you money to pay off your debts? Consider promising them a return on investment. For example, you could pay them 5 percent interest on the loan and still save a vast amount of money if the interest on your debts is high.

Of course, it's vital that you pay back these loans. Because you have an insider's view of what it's like to be strapped for cash, you certainly don't want to put anyone you care about in a similar position. Besides, it's almost impossible to overstate how important it is for your self-esteem, your sense of accomplishment, and the success of your long-term goals that you pay back all debts, including (and maybe especially) those owed to family.

Filing for Bankruptcy Protection

If you say "debt," most people immediately think "bankruptcy." Canada is facing an epidemic of personal bankruptcy. But bankruptcy is not an easy solution. It can seriously disrupt your life, it ruins your credit history, and it's possible it won't get rid of most of your debts. Make sure you know all the facts before you consider this dreadful option.

Your best bet — Avoid bankruptcy

If a chronic gambler deserts his wife and leaves her with a hefty mortgage, $90,000 in credit card debt, and six children, she might want to consider bankruptcy. For almost everyone else, bankruptcy is probably a bad choice. Here's why:

- You can lose much of your personal property. (The court sells the property to pay your creditors. If you're going to lose everything anyway, why not sell it yourself? You'll probably get a better price for it, and you won't have a bankruptcy ruining your credit report.)
- The blot remains on your credit record for eight years, so you probably won't be able to take out loans, get credit cards, or do anything else that requires a review of your credit record.
- If a friend or relative co-signed a loan, they are not protected by your bankruptcy and will have to repay your debts.
- Bankruptcy takes away the safety net of security that credit can supply your family.
- Bankruptcy hurts innocent people who trusted you to repay. It has a major impact on merchants and lenders and can, in the long run, mean job loss or business closure.
- You aren't likely to learn the necessary lessons to keep you from repeating your folly. In fact, a staggering 50 percent of the people who file bankruptcy file again later in their lives because they have changed no patterns and learned no new skills.
- You reveal your unfortunate financial lifestyle to the public in technicolour. Your bankruptcy petition, schedules, and payment plan are public documents. It's almost like having a tattoo on your forehead — especially in the business world.
- If you have a job that involves being bonded (bank teller, jewellery clerk), it may be in jeopardy.
- Bankruptcy is humiliating. It seriously undercuts your self-esteem and really makes it difficult for you to make positive changes in your life.

Many of these points apply only if your filing is successful, which is not necessarily guaranteed. If you fail to follow any of the necessary steps, such as showing up for the creditors' meeting, answering the court's questions honestly and completely, or producing the necessary and verifiable books and records, the case can be dismissed. If this happens, you still owe everything you did before you started, and you're out whatever you've spent so far on bankruptcy proceedings.

How bad is it?

Canadians have taken on a lot of debt, as noted in Chapter 2. When the economy slows down, jobs are lost. When people lose their jobs, they often lose the means to pay down their debts. If debts cannot be further deferred or restructured, bankruptcy becomes a likely next step.

In Canada, the fairly recent consumer (non-commercial) bankruptcy landscape looked as follows:

- 2007: 86,000
- 2006: 79,218
- 2005: 84,638
- 2004: 84,426
- 2003: 84,251
- 2002: 78,210
- 2001: 79,398

As the U.S. sub-prime mortgage lending crisis deepened in 2007, and as credit became harder to get in Canada as a result, the number of bankruptcies edged up. In fact, it seems that regardless of the state of the Canadian economy, bankruptcies happen.

Today, too many people are filing for bankruptcy to escape debt that is merely inconvenient. The courts are getting stricter, and are looking more closely at all cases. Judges are diligently on the lookout for people who are simply trying to get out of paying their bills, as opposed to those who are truly suffering hardship. If a judge determines you have enough income to cover the monthly payments for your debts, and especially if you have any discretionary income left after making those payments, your bankruptcy case likely will be thrown out of court.

Understanding dischargeable and nondischargeable debts

Not all debts go away when you file for bankruptcy. Most unsecured debts are *dischargeable,* which means you are no longer legally required to repay them. However, some unsecured debts are *nondischargeable* — that is, you still have to repay them even after filing for bankruptcy. For secured debts, you surrender the property you used as collateral, or pay the debt if you want to retain the collateral.

Which type of debt you have determines whether you have anything to gain from declaring bankruptcy.

- **Dischargeable debts** include, but are not limited to, credit card purchases, rent, and health care bills.
- **Nondischargeable debts** include, but are not limited to, student loans, alimony or child support, any debt or liability arising out of fraud or embezzlement, debts incurred as a result of criminal acts, and eve-of-bankruptcy spending sprees (or any substantial purchases close to the time of filing).

In addition, after you file for bankruptcy, your creditors have 45 days to object. If they file a suit, it's possible that a discharge will be denied for the debt in question.

You can't really guess what the judge will decide about your creditors' suits (unless you know one of your creditors is in worse shape financially than you are), but you should be able to identify your dischargeable debts. If that's what most of your debts are, then bankruptcy can help reduce your debt burden — but don't forget, that doesn't mean it makes your problems go away.

Alternatives to bankruptcy

Bankruptcy is a drastic move with serious long-term consequences. Consider these options first:

- **Talk to your creditors:** Hard as it may sound, you can call up your creditors and explain why you haven't made your payments. Ask for lower payments over a longer time frame. They may allow it.
- **Credit counselling:** Credit counselling services differ from province to province, but all of them can give sound advice on creating a budget and sticking to it.
- **Consolidation order:** If you live in British Columbia, Alberta, Saskatchewan, Nova Scotia, or P.E.I., you can apply for a consolidation order, which defines the amount and the times that you have to make payments to the court. The court will then pay your creditors. (In Quebec a similar option is called a voluntary deposit.) With a consolidation order you can pay off your debts over three years and you're free from wage garnishees and harassment from creditors. Plus, you get to keep your stuff.
- **Consumer proposal:** Under the Bankruptcy and Insolvency Act, you may make a proposal to your creditors to reduce the amount of your debts, extend the time to repay the debt, or provide some combination of both. (More on this in the next section.)

If none of these methods solves your debt problem, then you may want to consider bankruptcy.

The consumer proposal

As a last measure before declaring outright bankruptcy, you can make a consumer proposal to your creditors that you pay less each month over a longer period of time, or pay a certain percentage of what you owe. The main benefit is that your unsecured creditors cannot take legal steps to recover debts from you — such as seizing property or garnisheeing wages. You can make a consumer proposal if your debts total less than $75,000, not including a home mortgage.

The procedure begins when you seek the help of an administrator, who may be a trustee or someone appointed by the Superintendent of Bankruptcy. He or she will assess your finances, and give you advice about what kind of proposal may be best for you and your creditors. You'll have to sign the required forms, and the administrator will send the proposal — along with a report that lists your assets, debts, and creditors — to the Official Receiver, as well as to each of your creditors. The creditors then have 45 days to decide whether to accept or reject your proposal.

If your creditors accept it, your consumer proposal determines the amount and time periods by which you'll clear yourself of debt. If they reject it, then just about the only option left is bankruptcy.

It will cost you money to make a consumer proposal: You have to pay a filing fee to the Superintendent of Bankruptcy, and the administrator will expect to be paid. The fees for administrators, however, are determined by law. You can check them out at the Superintendent of Bankruptcy's Web site, at `osb-bsf.ic.gc.ca`.

Starting bankruptcy proceedings

Bankruptcy is a legal process outlined in the Bankruptcy and Insolvency Act of Canada. Because you can't pay your debts, you assign all of your assets, except those exempt by law, to a licensed trustee in bankruptcy. This process relieves you of most debts, and legal proceedings against you by creditors should, in most cases, stop.

Finding a trustee

In bankruptcy proceedings, a trustee is someone licensed by the federal Superintendent of Bankruptcy to represent your creditors and act as an officer of the court. But the trustee can also be your best friend, giving you information and advice about the bankruptcy process and making sure that your rights, as well as the rights of the creditors, are respected.

Trustees in bankruptcy are usually listed in the telephone book under "Bankruptcy" or "Trustee," or in the provincial government section. If you can't find a trustee, contact the nearest office of the Superintendent of Bankruptcy at Industry Canada.

Besides the trustee, the other major participant in a bankruptcy is the inspector. Inspectors are appointed by your creditors to represent them before the trustee, and are expected to assist and/or supervise the trustee during bankruptcy proceedings.

Surrendering your property

When you declare bankruptcy, your property is given to the trustee, who sells it and distributes the money among your creditors. Your unsecured creditors will not be able to take legal steps to recover their debts from you. Also, all property used as collateral for secured debts returns to your creditors. (If you want to keep it, you must pay for it.)

As with a consumer proposal, first you have to meet with a trustee who will assess your financial situation and explain your options. If you decide to go through with the bankruptcy, the trustee will ask you to surrender your credit cards, and will help you complete several forms you'll have to sign. You're considered bankrupt only when the trustee files these forms with the Official Receiver.

You have to sign at least two forms. One is an "assignment"; the other is your "statement of affairs." In the assignment, you state that you are handing over all of your property to the trustee for the benefit of your creditors. In the statement of affairs, you list your assets, liabilities, income, and expenses. As well, you have to answer several questions about your family, employment, and disposition of assets.

Although the trustee prepares the forms for you, you are responsible for making sure they are accurate. Review them carefully before you sign. Keep copies of notices and all other documents the trustee sends to you.

Usually, a meeting of creditors isn't necessary when you've filed the forms and declared bankruptcy. But sometimes the creditors or the Official Receiver may request one. If a meeting of creditors is called, you must attend. You may also be required to go to the Official Receiver's office to answer questions about your financial affairs under oath.

If all goes according to plan, and this is the first time you've declared bankruptcy, your debts will be discharged automatically after nine months. That means you're relieved of most of your debts.

Great, huh? Well, not quite, because most of your worldly possessions have been sold to pay off whatever outstanding debts can be paid. On the other hand, bankruptcy is designed specifically not to leave you destitute. By law, you will be allowed to keep certain possessions the government deems necessary for your survival and well-being: food, clothing, a portion of home equity, medical and dental aids — that sort of thing. What you are allowed to keep differs widely from province to province, so be sure to check with your trustee about what you'll be left with when the ink dries on your bankruptcy forms.

You can now begin the process of rebuilding your life, with no credit, little property, and a seriously damaged credit history, and still carrying any nondischargeable debts that are outstanding.

Determining whether bankruptcy is for you

Before you go to the trouble and expense of beginning the proceedings, appraise your situation and determine if you have anything to gain from filing bankruptcy. Gather your debt worksheets and your budget, then ask yourself the following questions and think about what your answers may mean when you're considering bankruptcy. Be precise and realistic, because the trustee and court officials will be.

- **Do you have any discretionary income left after you make the minimum payments on all bills and cover all essential expenses?**

  If your answer is yes, forget bankruptcy. More than likely, your application will be dismissed.

  If your answer is no, go on to the next question.

- **Would a trustee be likely to view any items in your budget as nonessential?**

  If your answer is yes, you have two options: Eliminate the item yourself and put the money toward your bills, or, if the item is important to you, avoid bankruptcy so you can retain your option of spending that money.

  If your answer is no, go on to the next question.

- **Are you behind on payments of secured debts, such as mortgage and car payments?**

  If your answer is yes, contact the creditors and try to make arrangements to catch up on payments.

If your answer is no, continue to pay your bills and budget carefully; you're probably not a good candidate for bankruptcy.

- **Compare all the debts on your debt worksheet to the list of nondischargeable debts earlier in this chapter. Is a considerable portion of your debt nondischargeable?**

  If your answer is yes, you have little to gain from filing for bankruptcy.

  If your answer is no, go on to the next question.

- **Do you have property you could sell (that is, without liens or other impediments) that would probably be taken from you if you filed for bankruptcy?**

  If your answer is yes, you may want to sell it yourself, apply the money toward your bills, and keep your credit record clean.

  If your answer is no — that is, either you have no property that could be taken away or liens exist on the property, so it couldn't be sold — bankruptcy may be an option.

- **Did a friend or relative co-sign any of the loans the bankruptcy would affect?**

  If your answer is yes, talk to that individual to find out if he or she is able to repay, because the debt will become that person's if you file for bankruptcy. If your friend or relative can repay, perhaps he or she can do so without having you file, and then you can repay that individual in time.

  If your answer is no, continue looking into bankruptcy if you feel it's necessary.

Pretty much all the other considerations are personal or emotional. Are you comfortable with having officials establish your budget? Are you comfortable with the thought of having this mark against your credit history for years and being unable to get loans, credit cards, and so on? Do you lack the discipline to carry out a repayment plan without the threat of legal intervention? Are you willing to give up much of your property to creditors? Will you be able to recover emotionally from the process? Indeed, the bankruptcy process is about as much fun as an expensive root canal.

Chapter 4

Budgeting and Record Keeping

In This Chapter

- Categorizing your spending into essentials and nonessentials
- Controlling your impulse spending
- Dealing with emergency expenses
- Making a habit of using a budget
- Saving time and frustration by getting organized

Pulling together all your financial information and building a budget aren't that hard. The challenge comes when you try to stick to that budget. Suddenly, you realize sticking to your reduced clothing or food allowance is pretty tough. This chapter gives you the tools to help you make that budget stick.

Determining Your Essential Expenses: What You Need

Essential fixed expenses are those obligations you must pay regularly — usually monthly. Essential fixed expenses are the same month after month.

Although most people don't consider charitable contributions to be essential expenses, you can put those items in the essential category if you want to pay them regularly, and if they are important to you.

Essential variable expenses are due every month, but the amounts vary from month to month: food, gas, electricity, long-distance telephone expenses, and so on. In this category, you prorate (average) regular expenses to a monthly cost. Do so by figuring your yearly cost and dividing by 12 (if you're using a monthly budget) or 52 (if you're using a weekly budget).

Essential fixed expenses include

- Insurance that you pay quarterly, semi-annually, or annually
- Mortgage payment or rent
- Automobile payment
- Student loan payment

Essential variable expenses include

- Groceries
- Utilities (gas, electricity, water, and so on)
- Public transit fares
- Gasoline
- Auto repairs and maintenance
- Health care and pharmaceuticals
- Haircuts, toiletries, and other personal care items
- Education and professional development costs (for your children or yourself)
- Savings for retirement
- Savings for large expenses, such as furniture, appliances, and replacement automobiles

As you update your budget, you'll remove items such as student loans as you pay them off.

Determining Your Nonessential Expenses: What You Want

After you pay your essential expenses, what you have left is your discretionary income. From that, you pay your nonessential expenses (and put the rest in savings and investments).

Nonessential expenses include the following:

- Books, magazines, and newspaper subscriptions
- Restaurant meals
- Movies and concerts
- Gifts

- Vacations
- Hobbies

Chapter 1 in Book I lists various money personalities. These personalities identify how you feel about money and spending. Recognizing your money personality — and the money personalities of family members — helps you make better decisions about the money you've identified as nonessential spending.

In creating your budget, you're looking toward the future. You want to determine which items you listed as fixed expenses really should be considered nonessential. You may be shocked at the total of these items, but don't be discouraged.

The whole point of a budget is to have a plan for your money before you spend it. Without a budget, you can leave the house with $200 in cash, come back five hours later, and be able to account for only half that amount. With a budget, you'll never do that again. More importantly, you'll be able to make firm spending decisions based on criteria you have already set for yourself.

Recognizing and Avoiding Hidden Expenses

Hidden expenses are those sneaky money-eaters that lurk everywhere. Knowing what and where they are and how much they cost helps you cut them by avoiding the items to which they are attached. This section identifies these hidden costs.

Bank machine, bank, and credit card fees

Hidden costs can quickly transfer your money from your pocket to an institution's profit statement. Be careful of the following:

- Annual fees
- Below-minimum use and below-minimum balance fees
- High interest rates
- Late-payment penalties
- Independent (or "white label") ATMs (automated teller machines) not affiliated with any financial institution that charge fees of up to $3 for cash withdrawals.
- Per-use fees

Read all "change of terms" inserts you receive from banks, credit unions, credit card companies, and the like. The information they contain may be a wake-up call to change how and where you do business.

Not knowing what fees you're liable for with your money-handling institutions is the same as using a credit card without knowing what rate of interest you're paying. If you don't carry a balance on your credit card, the interest rate is irrelevant. If you don't incur fees from your bank and so on, you don't care what that rate is, either. But you need to know what and how much they are so you know what to do to avoid them.

Gratuities and delivery charges

The more services you use in your lifestyle, the more you pay in gratuities and delivery charges. Having meals or groceries delivered is convenient and may save you time, but in addition to paying for what you eat, you pay delivery costs and a tip to the delivery person — neither of which you can have for dessert.

Catalogue and Internet shopping can save a lot of time, along with parking and car-use costs. An add-on cost, however, may be shipping charges (often unrecoverable if you return the item). You may need to pay insurance costs as well, to protect against the item getting lost or damaged in transit. Plus, when you buy something in a store, you can inspect it before you take it home. And you can watch for sales.

This doesn't mean you should always shop in stores; it just means you need to know and compare the costs of various ways of taking care of your needs. If you use the time you save to earn more income, for example, the convenience may be worth the cost.

Sales, luxury, and utility taxes

Not all items are taxed at the same rate. Basic groceries, for example, are not taxed anywhere in Canada, but "snacks" (basically anything that can be eaten in one sitting) are, in some jurisdictions.

Governments have determined some items as luxury items. Liquor is a common example. In some places, the tax on a soft drink is lower than the tax on a beer — even though most people drink either one or both. The choices you make in what may seem to be the same category can lower these hidden costs. Read your receipts carefully. These days, most cash registers put added taxes, such as those for liquor, next to the item purchased so you can readily see how much you're paying for items for which substitutes may be available.

Choosing one item over another may not save you a ton of money, but making saving decisions over and over can help put you on the path to financial security.

Factoring in Emergency Expenses

You don't want to panic every time the refrigerator breaks down or the dog eats spoiled food and has to go to the vet. The budget you'll create later in this chapter reflects that emergencies do happen, so you'll have the savings put aside to pay for such contingencies.

You can move some items from the emergency category to a "savings for replacement" category by keeping track of those budget items. For example, one of the biggest money-eaters in the emergency category can be your automobile, especially if it isn't maintained properly and regularly.

Table 4-1 can help you keep track of your car's care and feeding. List all repairs, regular service (whether done at a service station or by you), and tire purchases. Review your car's service manual to be certain you're following the manufacturer's recommendations. A little short-term pain in the form of upfront maintenance expense usually goes a long way toward long-term gain in the form of extending your vehicle's life!

Table 4-1 Automobile Maintenance: Major Repairs

Date	*Odometer Reading*	*Repair Description*	*Repair Warranty*	*Cost*	*Date Last Done*

When deciding which auto parts to buy, the existence of a warranty and its terms can be deciding factors. Keeping track of the life of the warranty helps you get your dollar's worth. If a shop wants to add chargeable parts or labour to those covered by the warranty, push back hard by asking to see what needs to be replaced and why.

Some warranties are *prorated* (the cost for wear and tear is deducted), and others offer *replacements* (you get a new tire or other part). Knowing what you're buying makes comparison shopping easier.

Keep similar records on major appliances and furniture. Table 4-2 shows you what information you need to plan replacement purchases.

Table 4-2 Major Purchases/Replacement Needs

Item	*Date Purchased*	*Warranty Length*	*Expected Life*	*Purchase Price*	*Replacement Cost*	*Expected Replacement Date*
Central air conditioner						
Clothes dryer						
Clothes washer						
Computer equipment						
Dishwasher						
Furnace						
Garage door opener						
Lawn mower						
Microwave						
Refrigerator						
Sofa						
Sound system						
Stove						
Sump pump						
Television						

Item	*Date Purchased*	*Warranty Length*	*Expected Life*	*Purchase Price*	*Replacement Cost*	*Expected Replacement Date*
Vacuum cleaner						
Water heater						
Other _____						
Other _____						
Other _____						

Now that you have an idea of how much money you need to keep in an account to be able to pay cash for these items as you need them, you can put these amounts in your budget. You may choose to save up the money for these items in your emergency fund, but we suggest you set up a household expenses fund to cover them.

Accounting for Taxes

Most people have their taxes deducted from their paycheques and don't need to deal with them separately until they file their tax returns. As your investment plans bring in more dividends and income, or if you take on another job that doesn't deduct taxes — for example, a freelance or contract job — be sure to review your tax withholdings and adjust them as needed. Doing so prevents a big tax bill at the end of the year; you avoid late filing penalties, too.

If, however, you're getting refunds — especially large refunds (you get to define large for yourself) — you need to make adjustments so the taxes you pay throughout the year better reflect your liability. A refund is not "found money." It's money you loaned to the government without earning interest on it. You wouldn't put your money in a zero-percent-interest savings account, so don't loan the government money at zero-percent interest.

You may be getting a refund because:

- You haven't claimed the number of deductions to which you're entitled. Be sure to adjust your deductions as your family situation changes.
- You deliberately paid additional taxes because you expected to earn outside income from which tax deductions would not be taken; then you didn't earn that income.

- Your employer deducted too much according to the number of dependants you're claiming, or you didn't update your deductions as your circumstances changed.
- You worked overtime. The tax table assumes you were making that income every week, resulting in too much tax being withheld.

Paying Yourself First

Paying yourself first is one of the best money management decisions you can make. Simply put, paying yourself first means you put money into a debt reduction or savings program to meet your short-term, mid-term, and long-term goals (see Chapter 2 in Book I) before you pay anything else — including your rent or mortgage! If you're living from paycheque to paycheque, you may think you can't do this. But determining where you spend your money shows you how you can pay yourself first and gain many benefits.

One thing you discovered when you tracked how you spent your money in the past is that emergencies always get paid somehow. If an insurance payment came due, you skimped on restaurant meals or entertainment so you had enough money to pay that important bill before your insurance was cancelled.

If you can "find" the money when you absolutely must have it, then you can live on less than you've been spending. The obvious conclusion is that you can put money aside for savings if you respect yourself enough to pay yourself first.

Chapter 5 in Book I goes into detail about lowering your expenses. For now, it's enough to identify the money you didn't need to spend. Put that money in the savings category of your budget. When the insurance payment came due, for example, you told yourself you didn't have money to spend on restaurant meals or movies. Isn't your future at least as important as paying for your insurance?

You'll find that when you have savings (and you will), the lowered stress, greater stability, feeling of financial security, and general well-being you enjoy are worth much more than the time and effort you invest in creating and maintaining your budget.

Setting Up a Basic Budget

Discovering and dealing with your spending personality type give you hints on how to change your habits to create a realistic budget and keep it up to

date. This section shows you how to set up a budget that reflects the reality of your current financial life.

Table 4-3 is a sample budget to show you what your budget may look like. Using the information from your spending diary, insert the values for what you paid in each category last month in the Last Month Actual column. After you determine what you should be spending in each category, put those amounts in the This Month Budget column. At the end of another month, put the amount you actually spent in each category in the This Month Actual column.

This budget leaves you space in the Over/Under column to compare each item's real value with its real cost. When you compile your budget, you want to be able to compare real versus projected values on a monthly, quarterly, and yearly basis.

Note that these categories are not the same as those in Table 2-2 of Chapter 2 used to calculate your debt. You'll determine which categories you need to include, so we want to show you how budget worksheets can vary. Choose categories that reflect your situation.

Table 4-3 My Monthly Budget

Expense	*Last Month Actual*	*This Month Budget*	*This Month Actual*	*Over/ Under*
Housing and Utilities				
Mortgage or rent	$	$	$	$
Homeowners' or condo assn. fees	$	$	$	$
Electricity	$	$	$	$
Gas	$	$	$	$
Water	$	$	$	$
Telephone	$	$	$	$
Home maintenance	$	$	$	$
Subtotal, Housing and Utilities	**$**	**$**	**$**	**$**
Food				
Groceries	$	$	$	$
Restaurant meals	$	$	$	$
Subtotal, Food	**$**	**$**	**$**	**$**

(continued)

Table 4-3 *(continued)*

Expense	*Last Month Actual*	*This Month Budget*	*This Month Actual*	*Over/ Under*
Clothing and Shoes				
Adult 1	$	$	$	$
Adult 2	$	$	$	$
Child 1	$	$	$	$
Child 2	$	$	$	$
Subtotal, Clothing and Shoes	**$**	**$**	**$**	**$**
Insurance				
Auto	$	$	$	$
Health	$	$	$	$
Homeowner's/Renter's	$	$	$	$
Life	$	$	$	$
Other	$	$	$	$
Subtotal, Insurance	**$**	**$**	**$**	**$**
Health care				
Dentist	$	$	$	$
Doctor	$	$	$	$
Optometrist	$	$	$	$
Other practitioner	$	$	$	$
Eyeglasses, contact lenses	$	$	$	$
Prescriptions	$	$	$	$
Other	$	$	$	$
Subtotal, Health care	**$**	**$**	**$**	**$**
Auto				
Gasoline	$	$	$	$
Maintenance	$	$	$	$

Expense	*Last Month Actual*	*This Month Budget*	*This Month Actual*	*Over/ Under*
Payment	$	$	$	$
Tolls	$	$	$	$
Taxis and public transportation	$	$	$	$
Subtotal, Auto	**$**	**$**	**$**	**$**
Personal				
Charitable contributions	$	$	$	$
Child care	$	$	$	$
Cosmetics	$	$	$	$
Entertainment	$	$	$	$
Haircuts	$	$	$	$
Magazines/newspapers	$	$	$	$
Membership dues	$	$	$	$
Vacations	$	$	$	$
Other	$	$	$	$
Subtotal, Personal	**$**	**$**	**$**	**$**
Savings and Investments				
Savings/Money market account	$	$	$	$
Education fund	$	$	$	$
Mutual fund	$	$	$	$
New car fund	$	$	$	$
New home fund	$	$	$	$
Retirement fund	$	$	$	$
Emergency savings account	$	$	$	$
Other	$	$	$	$
Subtotal, Savings and Investments	**$**	**$**	**$**	**$**

(continued)

Table 4-3 *(continued)*

Expense	*Last Month Actual*	*This Month Budget*	*This Month Actual*	*Over/ Under*
Taxes				
Federal income tax	$	$	$	$
Provincial income tax	$	$	$	$
CPP/EI	$	$	$	$
Property tax	$	$	$	$
Subtotal, Taxes	**$**	**$**	**$**	**$**
TOTAL EXPENSES	**$**	**$**	**$**	**$**
Income				
Gross wages 1	$	$	$	$
Gross wages 2	$	$	$	$
Interest income	$	$	$	$
Alimony/Child support paid to you	$	$	$	$
Other	$	$	$	$
TOTAL INCOME	**$**	**$**	**$**	**$**
Difference between income and expenses (put shortages in parentheses)	**$**	**$**	**$**	**$**

Often, your mortgage, property taxes, and insurance are lumped together in one payment. Don't "charge" yourself twice if you pay these expenses as part of your mortgage payments.

Make sure to account for all your expenses, but put them in any category that makes your budget work for you. For example, you may want to put your homeowner's or renter's insurance under Housing and Utilities rather than under Insurance. Moving items to other categories will reflect how you spend your money; your budget will reflect how you want to allocate your resources. Also, as you recognize new items, add them to your budget.

Sticking to Your Budget: Be Disciplined

Realizing you need a budget, gathering your information, and putting that information into a usable form are giant strides toward securing your financial future. This chapter shows you how to build on the foundation you established by creating a budget.

You have many good habits that took time to cultivate. Sometimes it's hard to remember them because when you have a good habit, you don't really think about it until you start to lose that good habit. Give yourself credit for developing habits such as the following:

- I brush my teeth every day.
- I change the oil in my car regularly.
- I send birthday cards to my friends and family.
- I get to work on time.

In the interest of appreciating that you can learn budgeting habits, too, check off in the following list those good habits you've already picked up:

- I pay my bills on time.
- I balance my chequebook.
- I compare prices when I shop.
- I verify the charges on my credit card statement.

None of these habits, by themselves, will make your life either wonderful or awful. But adding good habits on top of good habits improves your life immensely.

You can't just fling your old bad habits out the window. To learn to be an effective budgeter, you must coax yourself into developing good habits. Check off the following activities you can accomplish:

- Recognize how budgeting benefits me
- Notice changes in my spending habits and decide whether the changes are good or bad
- Revise my budget when my circumstances change

- Seek help when I need more information
- Set aside time every week to review my budget
- Write down changes I want to make instead of keeping them in my head

Failing to use and revise your budget has many drawbacks:

- You miss out on the many benefits budgeting brings to your financial life, such as the ability to make reasoned decisions rather than react to situations.
- You waste the time you already spent collecting data.
- Your stress level rises.
- You don't feel good about yourself.

Reining In Your Impulse Spending

You're not entirely at fault if, every time you return from the store, you have more items than you intended to purchase. Store managers have studied consumers for years. Stores purposely use floor plans that tempt you to buy things you didn't know you wanted and expose you to as many buying opportunities as possible. For example, why is milk, probably the most-purchased item in any supermarket, at the back of the store? Those wily store managers know that if you have to look at long aisles of tempting items going to and from picking up your milk, your shopping cart will very likely end up with more than milk in it.

Don't confuse good buys with impulse purchases. If you find a half-price sale on something your family uses and you can use it all before it spoils, that's a good buying decision, unless it means you can't pay another bill and will have to pay a penalty on that bill.

Recognizing your triggers

Previously, you may not have thought of your purchases as being "triggered." But if the milk scenario seems familiar to you, then you have your own triggers. Common triggers are

- **Fatigue:** You work hard; you deserve a treat.
- **Hunger:** You don't have the energy to make a decision, so you treat yourself to junk food rather than a nutritious meal.
- **Overwork:** You've worked hard, so you feel you deserve a treat.

- **Money in your pocket:** You have the cash to pay for it, so why not have a treat?
- **Depression:** You try to make yourself feel better by buying yourself a treat.
- **Elation:** You think nothing can go wrong when you feel so good, so you have a treat.
- **Celebration:** You or your friend/sister/brother/roommate deserves a nice present to celebrate a birthday/anniversary/new job.
- **Competition:** You have to give the nicest gift, or at least one that's as nice as so-and-so's.
- **The desire to impress someone:** You think, "Wait until so-and-so sees this!"

Ensuring your long-term financial health is the best "treat" you can give yourself at any time!

You probably know the kinds of things you're most likely to purchase on a whim. Go to that area of your house and write down those things you've purchased so you can see how much money you've wasted by not making thoughtful decisions.

For example, are tools your weakness? Do you find it impossible to pass by a hardware store? Then take your survey in your workshop, garage, or tool shed. Or do you love buying yourself clothes? Then go to your closet. See the jacket you bought because the colour was beautiful? Of course, you have nothing that goes with it. How many items in your closet were on sale but don't really work well with the rest of your wardrobe?

Write down every item that falls into the impulse-spending category. You don't need to go through every door or find every impulse purchase, but do write down all the impulse buys you find in plain sight.

You'll use the list you make in the next section. If you're part of a couple or you're doing this exercise with your children, reassure everyone before you start this survey that its only purpose is to gather information.

If you use your survey to find fault with your or others' purchases, you'll quickly defeat the purpose and discourage helpful suggestions.

Before you go on, write an estimated cost next to each item. Then put a plus sign (+) next to anything you think you've used as much as you should have for the price. For example, you may have used your snow blower every time it snowed, but that means it has cost you $87 for each five-minute snow-removal job — no + there! And don't forget the cost to insure that expensive piece of equipment.

Now put an asterisk (*) next to each item for which you could have purchased a reasonable substitute at a lower cost. We're not talking about something that arbitrarily went on sale, but something for which a small investment of time would have resulted in paying a much lower price. Next to the asterisk, write the price you think you could have paid for a reasonable substitute. (Don't put garage-sale or second-hand-sale prices here — you have no guarantee you would have found a substitute.)

Don't ignore small impulse purchases. Although you may not have included those items on this list, you purchase them more often, so they add up quickly.

Stopping yourself from making a purchase

Now that you recognize what makes you indulge in impulse spending and what the payoff can be when you make informed purchases based on your financial goals, you can control your triggers. You can do so by making conscious decisions before the temptation to buy reaches out to grab you.

Setting your "stop" triggers doesn't mean you never get to treat yourself. If the supermarket is your downfall, for example, give yourself a set amount to spend any way you like. After a few trips to the store during which you can't decide what one treat you want, you'll find you don't want any of them all that much!

If your impulse triggers go off in the hardware store or another type of store that sells big-ticket items, again give yourself a "treat budget." If you don't have enough money to buy what you want today, you can save up your treat allowance until you have enough money in that "account." But you don't get to buy now and pay with your future allowance!

Rounding Up Your Support Team

All kinds of people and organizations are around to help you meet your goals. In the case of people, you need to know why they want to help you, how much time and energy they can offer, and what their individual money personalities are. You may want to review the section on identifying money personalities at the end of Chapter 1 in Book I before you assign helping roles to your support team.

Spouse/significant other

The best way to work as a team with your spouse or significant other is to agree on your goals and the prioritization of those goals. You may have to

compromise on individual goals in order to reach your goals as a couple or family.

Often, one partner is a better money manager than the other. That partner may be better at resisting temptation, computing amounts, dividing long-term goals into mid-term and short-term goals, setting priorities, balancing budgets, and so on. Or one partner may be better at some activities while the other is better at the remaining tasks.

The secret to a good partnership is jointly agreeing to goals and how you're going to reach those goals. Then each partner does the best job possible for his or her responsibilities. In spite of the word partner, you may decide to give one person more authority than the other — as long as you both agree on who should have more authority when it comes to financial matters, and you remember that financial security, not "being in charge," is your goal. As time goes on and changes need to be made, use the same negotiating and compromising that brought you as far as you are to help you set up a new system.

Children

If you have children, you certainly want to involve them in learning how to handle money. Keeping children involved in the budgeting process also helps them learn the financial lessons they need to know at each stage in their lives.

For example, when Charles's children started getting allowances, he deducted 10 percent from each child's allowance. Needless to say, the first few deductions caused much upset. The lesson was that adults don't get to keep all they earn because they must pay taxes. Just as adults get police and fire protection and roads to drive on from their taxes, the children got a place to live, meals, and vacations from their "taxes."

When the children's dog got sick, they had to use part of their savings to help pay the veterinarian's bill. They learned what savings were for and how they could meet goals by saving today.

No child is too young to participate in the family budget. But the younger a child is, the shorter term the goal must be to fit with young children's shortened attention span and patience. If your children are not part of your "budgeting board of directors," everyone gets cheated. They not only miss out on important lessons, but their feelings and wishes are not reflected in two strategic parts of family life: budgeting and buying decisions.

Parents

Your parents have lived longer and met and survived more financial challenges than you have. Their individual and collective money personalities are

important as to what kinds of help they can provide and what kinds of help you want from them.

If your parents can handle requests for loans and advice in a businesslike manner (and if you'll respond with an equally businesslike attitude), you can ask for loans and advice. If they have the attitude that whoever pays gets to make the rules, they'll probably want more control and expect answers to more questions than you're willing to give them. If you're desperate for their help, one of the compromises you may have to live with is that you must live with their money personalities. Try to avoid asking parents for money in the first place, because it can lead to family strife down the road.

Friends

Friends have many of the same pluses and minuses that parents do, except you aren't required to keep them forever. One of the benefits of friends' involvement in helping you reach your goals is that you can restrict them to just one area of your financial decision making. You may think you know your friends well, but personalities can clash when money enters the picture. If a friend gives you a loan, draw up a written agreement on the amount of the loan, when it is to be repaid, and how much interest is to be paid. If your friend suddenly decides the loan gives permission to tell you how to run your business or your life or your child's life, diplomatically remind your "friend" of the contract. Your friend will likely desire a written agreement anyway. If so, make sure to include the above provisions and any points of clarification.

Still, you may identify friends from whom you'd like advice on your finances. You can invite those friends into your financial circle based on your ability to work with the strengths and weaknesses of each person's money personality. If someone is a closer friend to one marriage partner than the other, the two of you must discuss and negotiate that factor as well. As you set financial priorities, your good relations with your partner must take precedence over getting advice or help from a friend.

Professional and free services

Professional sources can help you gather information, set goals, set priorities, or stay on your financial path. You can use these sources from the start, use them once in a while, or even discard them from your financial life when their purpose has been served.

Accountants do much more than fill out tax returns. They can help you set goals, remind you of factors you have forgotten or ignored, use their backgrounds with a variety of people's problems and solutions to help you pick

the best of both, start you on a good financial plan no matter what your age or income, help you revise your plans and goals as you get older, and — the part you'll probably enjoy the most — help you reduce the taxes you pay.

Depending on your accountant's practice, you may also be able to get information about estate planning, insurance practices, housing, health care, and scholarships.

Your employer, union, or trade organization may have an EAP (Employee Assistance Program). The services an EAP offers vary from provider to provider. Although some services may not be strictly financial, getting free or low-cost services in any area of concern will positively impact your financial situation and your ability to reach your goals.

Some EAPs offer budgeting, savings, tax, and estate planning services, either individually or in groups. The programs may also offer substance abuse help, family or individual counselling, workshops on buying and maintaining a home, and credit counselling. Whatever the topic, if you need information about it and don't pay for it, you've eliminated that budget expense while still learning what you need to know.

Your church or temple, community groups, credit bureaus, libraries, schools, financial institutions, and associations may offer budgeting and savings programs, either free or at a low cost. Look in local newspapers and newsletters for ads announcing such programs. Your local library or social service agency may also keep track of such listings.

The program offerings from these groups may also include

- Avoiding repair costs through regular maintenance
- Building (or rebuilding) a good credit rating
- Buying the right amount of insurance for you
- Evaluating banking services
- Handling credit wisely
- Avoiding the hidden costs of holiday shopping
- Learning about programs that help pay for education, health care, housing, and utilities
- Managing money
- Purchasing your first home
- Surviving a layoff or divorce

Many suppliers of such services offer customized programs.

Dealing with Emergency Expenses

Unexpected expenses can severely disrupt your financial status. The four situations that usually get people in financial trouble are

- Health care emergencies
- Vehicle repair and replacement
- Expensive appliances that wear out
- Helping family or friends with their money troubles

Those expenses are the reason you have an emergency expense fund. (If you don't, go back to Chapter 3 and revise your budget!) If your fund isn't large enough, however, you can take short-term actions to avoid ending up in a spiral of debt:

- If your income is low, ask a local government or social services agency if low- or no-interest loans are available for these types of emergencies. Religious organizations also may have such funds.
- Ask your credit card companies and other creditors to let you skip a payment without penalty. They'll still add an interest charge, which raises your total debt, but the tactic frees up immediate money so you can take care of the emergency.
- Pawn some possessions. Pawning is really a secured loan — you get cash in exchange for an item of value. If you pay back the loan (with interest, of course) by the deadline, you can retrieve your item.
- If you have a medical emergency, ask your health care provider about available services that would offset expenses for you, such as free or low-cost housing while your loved one is in the hospital and free or low-cost meals.
- If your problem is with your car and you have a good relationship with a garage, try to negotiate a time-payment plan at low or no interest (rather than the higher rate you would be paying on your credit card).

- Take out a home-equity loan or second mortgage. These are not the best choices, however, because the exposure to upward interest rate changes tends to be very high. Also, as we have seen in the credit crisis that began in 2007, this is a high-risk financial tactic. And remember to read the fine print. On some of those loans, you could lose your house if you miss one loan payment. Make sure, too, that you have the right to pay the loan off early to cut the interest expense.

- If you belong to a social or service organization, find out whether it has a formal or informal system for helping members. For example, a student from Norway who came to study in Canada discovered that because of a miscommunication, he had arrived two weeks before his housing was available. He was a member of Mensa, so he called the local contact. Someone in the local group put him up, rent-free, for the two weeks — and gave him a tour of the local area, topped off with a Labour Day picnic. (Geniuses stick together!)

Be creative. This is another situation in which knowing the financial (and other) personalities of your family members and friends helps. Either the boldest family member or friend, or the one with the strongest "saver" personality, will be the best negotiator for these perks.

Paying for an emergency by credit card may get you in debt at a high interest rate (in the high teens). If you must use a credit card, be sure to choose the one with the lowest interest rate (probably in the low teens). Now may be the time to take advantage of one of those low-introductory-rate cards a lender has offered to you — but do so only if you can pay off the balance before the end of the introductory rate expires, or if the regular rate is reasonable.

Organizing Your Records

Your role as a money manager won't seem so burdensome if you know you have what you need to succeed. Why begin a weekly or monthly money management session with a sense of frustration because you can't find the information you want or need? Make it easy for yourself and use the information in this chapter to support your money managing efforts.

Getting organized is at least half the battle in developing money management skills. If you just take the time, purchase a few supplies, and follow the simple steps identified in this section, you're well on your way as a successful money manager. Make an appointment to meet with yourself every week — a short, half-hour meeting will do. Then move into a monthly appointment where you allow an hour.

Getting started really doesn't take much. You need the following supplies to organize your financial records. If you don't have them, make a shopping list and go to the store:

- **Pens, pencils, paper, paper clips, and manila folders:** Tabbed folders let you see your records at a glance.

- **A file container:** You can use a cardboard box, a plastic crate, or a regular filing cabinet — whatever matches your budget.
- **Envelopes and postage stamps:** A box of business envelopes makes your financial correspondence and payments easier. Have a supply of stamps on hand, too, so you can be sure to make your payments on time.
- **An appointment book, notebook, or PDA (personal digital assistant):** Record your business appointments and any expenditures you can't track with receipts.
- **Software:** If you have a computer or PDA, add-on software programs (those that may not come with the computer or PDA) such as Quicken and Microsoft Money can help you organize and track financial information.

Creating folders for keeping your financial records

Label a folder (include the year on the label) for each of the following items that applies to your financial situation. Put your folders in alphabetical order in your file container. Add additional folders as your situation calls for them.

- Automobile — Insurance and loan
- Automobile — Maintenance
- Bank accounts
- Charitable contributions
- Credit cards
- Educational records, tuition receipts
- Health insurance
- Home — Improvements
- Home — Insurance
- Home — Maintenance
- Home — Mortgage
- Income tax — Federal
- Income tax — Provincial
- Insurance — Life and disability
- Loan (specify type)
- Mutual funds
- Property tax bills
- Real estate investment

- Registered Education Savings Plan (RESP)
- Registered Retirement Savings Plan (RRSP)
- Stocks
- Travel, passport, frequent flyer plans
- Warranties
- Will and/or trust

Consolidate all the information you have and add it to each folder pertaining to that file. Record essential information on the cover of each folder. Identify the name, address, phone number, and number for each account, policy, or whatever. Collecting this information takes a little time but makes contacts and record keeping much easier over the course of the year. Table 4-4 shows an example of what you may need for your insurance file. Fill in the information and staple it to the inside cover of the relevant folder. Some forms can do double duty.

Table 4-4 Tracking Insurance

Insurance (automobile, health, home, life, and disability):

Insurance company/Financial institution _____

_____

Address _____

_____

Phone _____

Name of representative _____

Phone if different from above _____

Claim number _____

Policy number _____

Payments _____

_____

Communication Log	Date	Name	Results

These basic forms illustrate the kind of essential information needed for each of your folders. When you have information at your fingertips, you put it to better and more frequent use.

Keeping personal records

You'll also benefit from keeping personal information in one place. So while you're organizing, set up a personal file with the following information:

- **Social insurance number(s):** Include your social insurance number, as well as those of your spouse, your children, your parents, and your siblings.
- **Contact information:** List the names and addresses of each of your adult children and your parents. Include work-contact information when available.
- **Passports and birth certificates:** Collect the original documents for each member of your family and keep them in this folder.
- **Marriage certificate/divorce decree:** Include your marriage certificate and/or divorce documents in your folder.
- **Personal will:** No matter what your age, make sure you have an up-to-date will. If you already have a will, take another look at it to see whether you need to make adjustments. If you don't have a will, make getting one a priority.
- **Living will:** You can ask your doctor to draw up a statement for a living will, or pick up a form to fill out. Share this information with your family and keep a copy in your personal folder.

Staying organized

Now that you've started the process of organizing your financial records, you want to stay on track. That means visiting your folders often, updating your financial information regularly, and maybe even scheduling a monthly appointment with yourself to help you stay organized and on track.

Chapter 5

Planning for the Inevitable: Taxes

In This Chapter

- Understanding income taxes
- Being aware of "hidden" taxes
- Amassing and organizing your tax records
- Staying out of tax trouble

Every day, you pay taxes. In provinces and territories that levy PST (provincial sales tax), a sales tax is added to the majority of your purchases. The federal government adds GST (goods and services tax) to many items you buy. (Your province might roll both taxes into a single "harmonized" tax — the HST.) The gasoline you buy includes taxes added on by federal and provincial governments. Receipts should show the breakdowns, so have a look next time you buy. This chapter helps you stay on top of taxes — both visible and invisible — so you don't ever have to face the ire of the Canada Revenue Agency (CRA).

Planning for Income Taxes

Income taxes have become so complex that most Canadians need help figuring out what they owe and how to report their income. Ignorance only compounds tax problems. You can't claim you don't know the tax requirements and expect your tax debt to be forgiven. Abundant books and pamphlets are written on this subject. The CRA has even developed and made available free publications to help you understand tax matters.

Staying informed

Purchase a tax preparation guide every year. These guides keep you informed and more than pay for themselves in the form of taxes saved. Even if you choose to have a professional prepare your taxes, the current tax guide enables you to ask informed questions.

You have to be informed about the CRA requirements. To help you do so, the CRA offers a wide variety of free publications you can order by calling 800-829-3676. You can also download publications and forms from the CRA Web site (www.cra-arc.gc.ca), or pick up information at your local library or bookstore. The Certified General Accountants of Canada publish an excellent annual basic tax guide you can download for free at www.cga-canada.org. Finally, you can always check out *Tax Tips For Canadians For Dummies,* a fun guide that takes you through the entire tax process, step by step.

Getting organized

Whether you do your taxes yourself or turn the task over to a professional, you need the proper records. More than half the time spent on preparing income taxes is related to keeping and organizing records and studying the rules and procedures for filing. If you keep good records, you've completed more than half the battle!

Set up a separate file drawer or box that can accommodate folders. At the beginning of each calendar year, buy manila folders and label them with the year and any of the following categories that apply to your situation. (No matter what time of year you're reading this, organize your folders for the current year now.) Then save your receipts and other information in the appropriate folders.

- **Income documents:** Your employer and financial institutions are required to send you income and interest information in January of each year. Your T4 form tells you and the CRA how much money you earned and how much was withheld.
- **Forms:** These forms report money you receive from freelance assignments, interest payments from banks, and stock dividends.
- **RRSPs:** A Registered Retirement Savings Plan is an account you set aside for retirement by using pretax dollars. You can deduct the amount you contribute to your RRSP from your taxable income.

  Interest on personal loans, credit charges, RRSP loans, and car loans is not tax-deductible.
- **Deductions — Charity:** You can deduct contributions you made to charitable and not-for-profit organizations. Some limitations apply, so save your receipts.
- **Medical/dental expenses:** All the family expenses should go on one tax return — schedule appointments to maximize the deduction whenever possible.

- **Moving expenses:** Many expenses connected with changes in the location of your employment can reduce your gross income if you move farther than 40 kilometres.
- **Home expenses:** Save all records and receipts connected with maintaining and improving your home. Part of those costs may be deductible if you have a home business office in your house.
- **Student loans:** Claim the tax credit for interest paid on student loans.
- **Deductions — Work:** The costs of certain tools, uniforms, memberships, training programs, mileage, and books can be tax-deductible if they're related to improvement and on-the-job training.

Deciding whether to itemize

Whether or not you do your own taxes, you have to decide whether claiming the standard deduction or itemizing your deductions will work better for you.

A qualified tax adviser can review your tax situation and recommend whether itemizing your deductions would be beneficial. Generally, if your tax situation is fairly simple, claiming the standard deduction is easier. If, however, you have had outstanding medical expenses, have purchased a home, or have made some other significant change in your life, itemizing deductions may be in your best interest.

If the total value of your itemized deductions exceeds the value of the standardized deduction, it's better to itemize your deductions and file the more detailed tax return. Take the time to complete the tax worksheets found in tax guidebooks and software. These worksheets can help you decide whether to itemize. In fact, if you don't use the prescribed forms, you may attract unwanted and time-consuming attention from the CRA, which prefers things to be done with their forms.

Getting the records you need

You use the same records to complete all your forms. See the section "Getting organized" for a list of these items. You file provincial income taxes simultaneously with your federal forms. Figures for adjusted gross income relate to the deductions for federal and provincial taxes. You receive income tax forms in the mail, or you can pick them up at post offices, public libraries, and tax preparation offices.

Knowing what gets taxed

Provinces, counties, and municipalities have the right to secure funding through taxation. And they're very good at identifying additional sources of revenue. Typically, provinces add their own taxes to the following:

- **Alcoholic beverage tax:** The range varies for various types of alcohol, but 10 percent is about the average. Beer, for example, is usually taxed at a lower rate than liquors that contain 20 percent or more alcohol. This kind of tax is sometimes referred to as a "sin" tax.
- **Fuel tax:** All fuels used on public highways are subject to tax. Of course, the more you pay for gas, the more tax you pay. Currently, fuel taxes represent about 5 percent of Canada's total tax revenue pie.
- **Motor vehicle registration tax:** A vehicle tax is imposed on automobiles, trucks, buses, tractors, motorcycles, semi trailers, and trailers for the privilege of using a motor vehicle in the province.
- **Tobacco tax:** Both the federal and provincial governments impose a cigarette tax in an effort to reduce cigarette consumption. In addition, a tax is imposed on other tobacco products, such as cigars and chewing tobacco. The rates vary.
- **Insurance tax:** Out-of-province companies and foreign companies doing insurance business within a province are subject to additional taxes for the privilege of doing business in that province. Basically, though, the taxes any company — even in-province — pays for the privilege of doing business in a province are passed on to the consumer of its goods or services.
- **Public utilities tax:** Suppliers of electricity, light, gas, and telecommunications within provinces are subject to various fees, taxes, and surcharges.
- **Real estate transfer tax:** In most provinces, municipalities charge a fee payable by the purchaser for buying real estate, including your home. This tax is paid when the deed is recorded with the municipality. More and more municipalities are trying to generate extra tax revenue by boosting the land transfer tax in tandem with rising real estate values.

Reducing How Much Tax You Pay

Although you can't spend all your time and energy looking for ways to avoid taxes, you can do some simple things to avoid paying more than you have to. Consider the following:

- **Contribute to an RRSP:** We know we've said this before, but RRSP contributions are the best way for all Canadians to reduce their taxable income. It's the most used method of reducing the tax you pay, and you might even want to consider taking out a short-term loan to make your contribution. You can pay off the loan with the tax refund you'll receive and beef up your plan in the process. Speak to your banker or investment adviser about how this works, and be sure to meet your loan commitments. Invest early, invest often, and end up with more money for yourself at the end of the day. Consider spousal RRSPs.
- **Contribute to an RESP:** Registered Education Savings Plans are good for your (grand)kids because you get free money from the government. It's true!
- **Split your income:** By splitting your income you lower your income. By lowering your income, you lower your taxes.
- **Keep good records:** Pay close attention to the section in Chapter 4 about organizing your financial records. Good tax planning really pays off. Believe it or not, if you know where you're at, you are more likely to file your return on time and accurately right off the bat.
- **Know when to get help:** Tax professionals can help you file a return that optimizes your deductions. Remember, though, they aren't miracle workers. If you feel like you're in over your head, seek their advice. Though you'll pay for it, you're likely to stress less and keep more in your wallet.
- **Spend less:** You have to pay a sales tax on whatever you buy, but if you don't buy the most expensive items available, you don't pay the maximum taxes. If, for example, you buy a luxury Oriental rug that costs $5,000, you'll pay a tax of, say, 8 percent. So a $5,000 rug actually costs you $5,400 with the sales tax. But if you buy a rug that costs $500, at the same sales tax rate, your rug costs only $540. Don't forget the 5 percent GST; that will add to your initial cost as well.
- **Buy store brands:** Many items, such as diapers, kitty litter, pain relievers, and water, to name a few — whether premium or house brands — accomplish the same thing when used properly. Why pay a premium price for a disposable item and pay the additional tax that goes with it?
- **Shop catalogues and Web sites:** When you buy an item from a catalogue, you may not have to pay the provincial sales tax on that item. That's the good news; the bad news, however, is that you pay a shipping and handling charge that often exceeds what you would pay in tax. Be careful purchasing from U.S.–based companies — you have to factor in not only shipping but also exchange and possibly even customs charges.
- **Barter:** As an individual, you may be able to trade one of your skills or services to another person with a complementary skill or service. And if

you can barter your plumbing skills for a friend's electrical skills, you can also avoid a cash transaction that requires a retail sales tax. (See Chapter 5 in Book I for more about bartering clubs.)

- **Take advantage of coupons, discounts, and bargains:** If you have the time and inclination, you can buy just about everything you need at a cheaper price somewhere.
- **Get Canadian dividends:** When you have money to invest outside of RRSPs and RESPs, get some Canadian investments that pay dividends. Then you'll get the dividend tax credit.
- **Deduct your interest expense:** Turn your loans from consumer loans (for example, to buy a TV) to investment loans (for example, to buy inventory) as soon as possible. In other words, if a loan is made for business purposes, then the interest is deductible. If it's for personal use of property, it's not deductible. So make sure that loans are for business purposes if you wish to deduct interest.

Avoiding Tax Trouble

No one wants a hassle with the CRA. Certain flags on a tax return increase your chances of being subject to a CRA examination, or audit. If you keep good records and file on time, you stand a good chance of steering clear of an audit. But you do need to consider the clues that the CRA looks for.

Staying alert to audits

The CRA generally considers the following situations red flags:

- Claiming more than 35 percent of adjusted gross income on itemized deductions
- Claiming persons other than children, grandchildren, or parents as dependants
- Claiming large deductions for travel and entertainment not in proportion to income
- Taking office-in-home deductions while employed elsewhere
- Clues to unreported income, such as an unusually low income in the restaurant business

- Underreporting tip income from businesses that receive gratuities
- Failing to report cash income for trades such as home renovations and garden maintenance
- Claiming high interest deductions
- Claiming bad debts
- Taking large depreciation and maintenance deductions for rental property
- Claiming high business use of a car in a business that traditionally doesn't have high car use
- Claiming disproportionate charitable donations

You have no cause for panic when you're audited if you've calculated your taxes fairly and kept good records. And not all audits result in additional tax charges and penalties. If you are audited, you're responsible for substantiating your claims with sufficient records. In many cases, the CRA will simply request additional documentation or an explanation.

You have rights as a taxpayer, and the CRA is required to inform you of these rights before an audit. You can ask for more time to produce the required documentation and ask to stop the CRA interview to consult with a tax adviser. You can bring an adviser or witness with you, and you can tape the interview. You also can appeal the audit findings. By keeping comprehensive records and filing honest returns, you should avoid an audit and any preliminary CRA enquiries altogether.

Doing the right thing

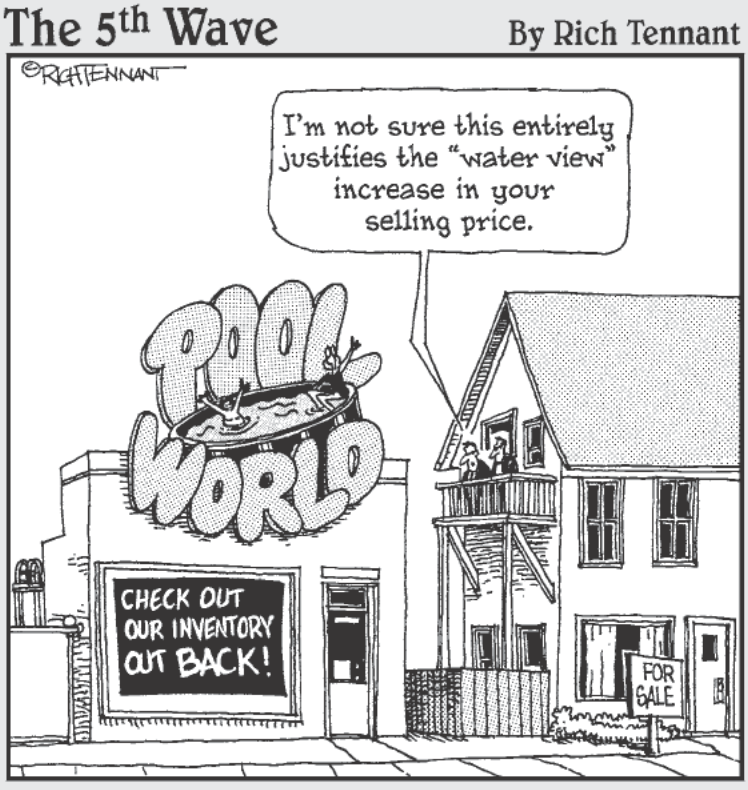
The complexities of tax law and tax reporting are daunting. Here are some tips for doing the right thing:

- **Be honest and fair.** Attempts to defraud the government by purposely giving false or incomplete information about a significant tax issue are punishable.
- **Keep meticulous records.** Good record keeping is the foundation of a solid defence of your position.
- **Order and use the CRA documents and assistance.** Filing forms and general guides are widely available. Look for them at your local Canada Post outlet, library, or tax preparation office, or check out the CRA Web site at `www.cra.arc.gc.ca`.

- **Pay for competence if you want someone to prepare your tax returns.** Tax preparers who are certified and sign your tax forms are generally more reliable than someone who has made a hobby of preparing tax forms. Go with the professionals; tax codes are complicated and you need the expertise of those who are informed with the current requirements. Ask your friends, family, financial adviser, or lawyer for tax preparer recommendations.
- **Use electronic filing.** The benefits of electronic filing are many: The CRA confirms receipt of your return, so you don't have to wonder about mail delays. Electronic filing is more accurate because it eliminates data entry errors at the CRA. And if you're expecting a tax refund, you'll likely get it quicker.

Book III

Home Sweet, Home Free



Contents at a Glance

Chapter 1: Deciding to Buy 147

Chapter 2: Discovering Your Perfect Home 173

Chapter 3: Getting the Home You Want 201

Chapter 4: Deciding to Sell 221

Chapter 5: Preparing to Sell Your Home 243

Chapter 6: Sealing the Deal 261

Chapter 1

Deciding to Buy

In This Chapter

- Determining whether you're ready to buy
- Looking at your finances
- Getting to know the types of mortgages
- Understanding mortgage lingo
- Checking out the various mortgage options
- Insuring your mortgage
- Choosing a mortgage lender

Dorothy said it best: There's no place like home. You may be a jet-setting entrepreneur or a stay-at-home parent, but we're willing to bet where you live now is your most cherished space. You need a place to wind down, to relax, and to rejuvenate. Whether you own or rent (or mooch off your parents), the place you call home is the foundation of your life.

We all want our homes to be perfect — even though our definitions of perfect change over time. Maybe as a teenager, your perfect bedroom was all black with huge speakers in every corner of the room. Twenty years, three children, two dogs, and a father-in-law later, your idea of perfect is an ensuite bathroom with good water pressure, a Jacuzzi, and a lock on the door. We all need a living space that can adapt to our changing needs and wants, and, of course, what better way to have that living space than to own it?

The idea of owning a home can be scary: Your water pipes could freeze and break, your basement could flood, your electrical system could need a complete overhaul. People can put thousands of dollars into their homes for renovations, thousands more for emergency repairs, and then there's daily upkeep, seasonal maintenance, taxes. . . . But ask homeowners if it's worth it, and they'll nod their heads vigorously and show you their Zen rock garden, the self-designed workshop in the basement, and the "Elvis room" with white and gold sequined walls, blue suede curtains, and pink Cadillac couch.

Even though owning your home can dictate how much money you have for other things — and leave you constantly worrying about finances — researching, planning, and being patient will help you stay in control. You

can and should decide how much home you can afford, and that's why this section of the book is geared toward getting you the home you want — at a price that doesn't leave you eating macaroni and cheese three times a day for the next 20 years. After all, you want your home to complement your lifestyle, not overrun it. You want enough money left over to create that "Elvis room" you've dreamed of.

Should You Buy Right Now?

Although you may think researching real estate markets and waiting for the right time to buy are the only ways to get a good deal, your personal situation is what should really determine your decision to buy. Are you able to pay your mortgage, utilities, taxes, insurance, and whatever maintenance comes up, not only for the next year, but also for the next 5, or 25? (We show you how to get a picture of your financial situation in this chapter in "Getting Up Close and Personal with Your Finances.")

Are you willing to remain in the same place for the next five years? Considering the closing costs involved whether you're a seller or a buyer (more on closing costs in Chapter 4), be prepared to keep your home for at least a few years. It's a good idea to avoid having to sell your home quickly, because chances are you would have to sell at a lower price. So even if the market is at an all-time low and interest rates are way down, buying a home could be a huge mistake if you're in the middle of a career change or planning a move to Luxembourg in a year.

Maintaining a home requires a big commitment — of money and time. Each season presents a list of chores to maintain your home's integrity and efficiency. Overlooking the overflowing eaves or the leaky roof may lead to significant water damage; neglecting your furnace could cause hundreds of dollars in repairs to it and to your frozen home. Many situations exist in which a little neglect can transform into expensive repairs and sometimes irreversible damage, resulting in huge losses when it's time to sell. If you don't budget the time and money for regular upkeep and preventive maintenance, be prepared to invest more time and money down the line.

Comparing renting to buying

Owning your home instead of renting almost always makes more sense in the long run, especially if you settle in one area. The biggest advantage of owning over renting is that a part of your monthly payments is an investment (and the payments will eventually cease!). The most common complaint about buying a home is having to pay the interest on the mortgage. Sure you can live with your parents until you've made enough money to buy a home outright, but your parents may not want to live with you for that long!

Renting your home instead of owning it does have advantages, and you'll have times in your life when owning isn't the best option for you. One of the biggest reasons to buy a home is for stability, but if you like your flexible lifestyle, this may be a burden to you. Owning a home is a serious commitment, and if your priorities aren't geared to making regular mortgage payments, or having a permanent address, it may be better to rent.

If you're in one of the following situations, consider waiting a while to buy a home:

- **Having financial woes:** Although you can leap into home ownership with as little as a 5 percent down payment or less, you still have to come up with that amount. And you'll have to be prepared to make those regular mortgage payments for what may seem like an eternity, not to mention all the other costs of being a homeowner. Getting a mortgage also might be tricky if you've neglected other loans, or have significant debts.
- **Living in transition:** You haven't decided to live in one place. Saddling yourself with a chunk of property and debt if you think you're really going to want to spend the next year beach-hopping around Portugal is not the best move.
- **Lacking job security:** If you end up relocating for employment, you may have to get rid of your home in a hurry. If you don't have a reliable or steady source of income, lenders may not be willing to authorize a mortgage because you can't guarantee you'll have more freelance work in the coming years.
- **Experiencing space uncertainty:** Although you can't really predict having triplets, there's no sense in buying a two-bedroom bungalow if you're pretty sure your brother-in-law's family of seven and their three dogs will move in with you for an unspecified amount of time. Unless this is your way of ensuring they can't live with you, you may find you have to change houses sooner than you'd like. If you are considering setting up a home office or starting a home-based business in the future, make sure you have a spare bedroom or room in the basement to expand.
- **Facing a bad housing market:** Generally speaking, focus on your own situation rather than the real estate market. But there may be a time when interest rates skyrocket and yet homes sell for twice as much as their listing prices — in these circumstances, it's probably better to wait until the market cools down to buy a home. If a monthly cost analysis shows that buying a home would be 20 to 30 percent more than renting a comparable home, think twice about buying.
- **Waiting for the gravy train:** You and your friend are starting a new technology company that will radically move the Internet into the next generation, and you need some start-up capital. You decide to invest all your savings in the company instead of in real estate. If your company takes off, you may be able to buy an estate in the south of France instead of a bungalow in the suburbs.

Considering common homeowning concerns

You may be skeptical about the complications of buying a home. Many different kinds of homes and ownership of homes exist, however, so you don't have to let your hatred of shovelling snow stop you from owning. The following are the most common reservations about home owning:

- **Unexpected costs:** One of the main arguments for renting is that you know what your monthly costs are, and they don't change. When you own a house, and the furnace breaks down, you have to fix it. But consider that when you rent, your landlord may not get around to fixing things right away, or he may be in Florida for the holidays and you may be stuck in the cold for a while. Although living in the same building as your landlord may guarantee some things are fixed in a hurry, your concern about a missing screen on your bedroom window may not be her priority. And maybe she likes the house at 18°Celsius during the winter and 30°Celsius in the summer. Sometimes paying the money to get things fixed is worth the hassle, but if you pay for a repair in your rented home, you may never see that money again.

  So, although the responsibility for repairs in your home will fall on your own shoulders, the main point is that you have the control. And with a mortgage, you know from the beginning how much you'll be paying each month for the length of your mortgage; with renting, it's hard to get that guarantee unless the rental market is full of vacancies.

- **Extra work:** Don't like doing lawn work, shovelling snow, fixing leaks? Your partner or child refuses to do your dirty work for you? Instead of renting to avoid such chores, you might prefer to buy a condominium or townhouse where someone else takes care of the maintenance. If you buy an apartment-style condo, you won't even have a sidewalk to worry about!

Keep in mind that when you move into a new home, you'll have new rates for some monthly expenses like utilities (heating, hydro, water). You may be taking on new costs such as property taxes and home and garden maintenance. New homeowners should also prepare for the worst by ensuring they have a reserve fund for emergency repairs. Make sure you have enough monthly income left over after your mortgage payments to cover these costs, as well.

Anticipating the typical costs for a new homeowner

Okay, so you want a better idea of exactly what kind of costs a new homeowner faces? Here goes.

- **Maintenance:** You may have a high-maintenance relationship or a low-maintenance relationship with the home you buy. Be sure your finances can handle the costs of regular repairs. Also, keep an emergency fund for unexpected repairs, and contribute to it on a regular basis. If you dip into it to help pay your way to Tahiti, that's your call, but be aware that your basement could be flooded when you return and you may not have the cash to pay the plumber.
- **Insurance:** You will need proof of fire and extended coverage insurance before you can finalize the purchase of your new home, because the property itself is the only security against the loan. If your new home burns down . . . well, you understand. Insurance costs vary, depending on your deductible, the value of your home and its contents, and the type of coverage you get, as well as each insurer's rates. Shop around for an affordable policy that covers the replacement of your personal property and grants you a living allowance if your home is destroyed. A policy with public liability insurance is also a good idea, as it protects you if someone is harmed on your property.
- **Utilities:** When you buy a home, you assume all the heating, cooling, water, and electricity bills for the property. If you live in the colder, draftier parts of Canada, you already know that heat is the most important utility. (And if you've ever rented a house and paid the hydro bill separately for electric heat, you've already been walloped by the biggest bill you've ever experienced.) If the house you're buying is new, you'll probably pay less for utilities because of better insulation and construction quality. If you're buying a resale home, ask the owners for copies of their utility bills so you can figure out average heating costs.
- **Taxes:** Property taxes are calculated based on your home's assessed value and the local tax rates. Unfortunately, property tax rates can fluctuate yearly, and they vary from region to region. Some real estate listings will state the amount of the previous year's taxes for the property being sold. When you're looking at new homes, find out from the selling agent or the owners what the previous year's taxes were. If you need a high-ratio mortgage to buy a new home, your lender may insist that property tax instalments be added to your monthly mortgage payments. (See "High-ratio mortgage insurance" in this chapter for more details.)
- **Condo fees:** The great thing about living in a condo is that someone else looks after all the pesky maintenance and landscaping stuff. The flip side is you have to pay for it in your condo fees. In addition to your mortgage payments, condo fees alone can easily cost as much as rent in a decent apartment. The condominium board can raise maintenance fees more easily than apartment owners can hike the rents!

Understanding the market

The housing market fluctuates, experiencing both strong and weak periods. History has shown, however, that the market will rise in the long run. So don't focus too much on waiting for the "right time" to buy. Predicting how the market will go is nearly impossible, and if you wait around forever for the market to be perfect, you'll waste tonnes of potential investment money on rent! Generally speaking, after you've bought your first home you'll continue to own it for years to come, and its value will increase if your neighbours continue to be gainfully employed. It's your personal situation that really should matter, because that will determine whether you have to sell the home in a hurry, and whether you can really afford to buy in the first place.

Having said all this, chances are you still want to know how the market works — periods occur when it's best to be a buyer (and, conversely, times exist when it's best to be a seller). You can see what the current market is like by checking out the prices in the local paper and asking your real estate agent how the current market compares to the past 12 months. Your agent can tell you how homes have been selling in the past year, what the median sales price was (the median sales price is the actual middle price between the highest and lowest selling prices, not the average price), and sometimes even how long homes were on the market, the types of homes sold, and their neighbourhoods.

A good overall economy will naturally produce a stronger market with more people looking to buy. Chances are, of course, there will be more sellers, because with more money, owners may decide to "trade up" and buy bigger homes. A strong economy also produces more construction and housing developments, opening up the market to more new homes.

A couple of terms and effects will help you understand the housing market:

- **Buyer's market:** Ideally, you want to buy when many sellers want to sell but few buyers are looking to buy. Homes take longer to sell, so buyers can take more time to make decisions. To sell a home in this market, the seller will have to list at a really good price and sometimes even offer other incentives, such as secondary financing (we discuss financing options in this chapter).
- **Seller's market:** The opposite of a buyer's market is a seller's market. Few homes are on the market, but buyers are plentiful, which results in fast home sales at prices close to, or even above, the listing prices. Some homes will sell even before they're listed. Because of the rise in sales, a lot of owners may sell their homes themselves. In a seller's market, buyers have less negotiating power, less time to decide, and may even find themselves in a bidding war for homes. So if you're buying in a seller's market, be prepared to make quick decisions. Have all your homework done and your financing arranged, including the ability to put down a large deposit quickly.

- **Seasonal influences:** Winter in Canada is notorious for being cold and unpleasant everywhere but the south coast of B.C. People don't like to venture out much, unless it's for necessities like groceries and hockey games (and skiing). Besides, who wants to look for a home when they're busy buying Christmas presents? Frostbite aside, the winter months also tend to be slower for the real estate market because people with children don't like to move during the school year. A lot of homes won't be on the market simply because sellers know their homes look best in the summer with the flowers, the leaves, and the sunshine. This means, of course, that the homes on the market at this time of year probably have to be sold urgently, so you might find a good bargain. You just might have to deal with snowdrifts and –40°Celsius temperatures on moving day. The exceptions to the rule are Toronto and Vancouver. For the past few years there's been no seasonal slowdown in these real estate markets.
- **Interest rates:** If you need a mortgage to purchase your home (lucky you, if you don't!), you'll find interest rates make a big difference in how much home you can afford. When interest rates are high, fewer buyers tend to be in the market for a new home. You can see the logic: A 6.5 percent interest rate on a $200,000 mortgage loan will cost you approximately $13,000 in interest in one year, while the same $200,000 loan at a 10 percent interest rate will cost you about $20,000 interest! Different types of mortgages can increase or decrease your interest rate from what banks consider the current standard.

Getting Up Close and Personal with Your Finances

Although examining your meagre income next to your substantial expenses can be depressing, you'll be even more depressed if you can't make your mortgage payments on your new home. In assessing what size mortgage you're eligible for, your lender (usually a bank or credit union) takes into account only those debts you have to pay. The really expensive food you buy for your 16 cats or the trips to Aruba you take every other month to work on your tan are not accounted for. If you don't want to find yourself with hungry rebellious felines, then examine your real monthly expenses to calculate how much of your income you can realistically put toward your mortgage payments. Take a look at Table 1-1: After you've deducted your total monthly expenses from your total monthly income, the remaining amount is what you can afford to pay toward your mortgage each month.

Table 1-1 Monthly Budget Worksheet

	Income	***Monthly Amount***
Net income after taxes		
Partner's net income after taxes		
Other income: Investments, gifts, annuity, trust fund, pension, and so on		
Total Income		
	Expenses	***Monthly Amount***
Investments		
RRSP		
Education funds		
Other		
Debts		
Credit cards		
Lines of credit		
Student loans		
Other loans/debt		
Transportation		
Auto loan or lease payments		
Insurance		
Registration		
Repairs/maintenance		
Fuel		
Parking		
Public transit		
Household Costs		
Groceries		
Laundry/dry cleaning		
Utilities		
Hydro/electricity		
Water		
Gas		

	Expenses	*Monthly Amount*
Home insurance		
Electronics		
Telephone		
Cell phone/wireless device		
Cable television		
Internet		
Health		
Medication		
Glasses/contacts		
Dental/orthodontics		
Therapist		
Special needs items		
Miscellaneous		
Life insurance		
Education		
Tuition fees		
Books/supplies		
Daycare		
Entertainment		
Restaurant meals		
Vacation		
Clothing/accessories		
Recreation/sports		
Membership fees		
Equipment		
Pets		
Gifts		
Other		
Total Expenses		

Understanding the Types of Mortgages

Mortgages break down into two types based on the amount of the down payment and therefore the amount of risk the lender is assuming by advancing you the money.

Conventional mortgages

A conventional mortgage covers not more than 75 percent of the purchase price of the home or the appraised value, whichever is lower. (See Chapter 6 for more information on home appraisals.) So if you want to buy a $200,000 home, you need a $50,000 down payment (25 percent of the purchase price) if you're applying for a conventional mortgage.

High-ratio mortgages

High-ratio mortgages account for between 75 and 100 percent of the purchase price of a house or condominium or the property's appraised value, whichever is lower. If you purchase a property with a down payment of less than 25 percent, your mortgage will need to be insured by either Canada Mortgage and Housing Corporation (CMHC) or Genworth Financial. The insurance protects the lender if you default on your mortgage. An insurance premium ranging from 0.5 to 2.9 percent of the mortgage amount, predetermined by a sliding scale, will be added to your mortgage and incorporated into your payment schedule. You may also have to pay an extra premium if you take out a variable rate mortgage (we talk about variable rate mortgages in this chapter).

A full list of the high-ratio mortgage limits, plus a wealth of other mortgage and real estate information, is available at the CMHC Web site at `www.cmhc-schl.gc.ca`.

Mortgage Basics and Jargon 101

One cool thing about getting a mortgage (unlike a computer, for example) is that every element has a clear purpose. Sit down with a pen and paper and calculator, or simply open your spreadsheet program on your computer and start plugging in numbers, and it all starts to make sense really, really quickly. Five chief elements are part of every mortgage:

- **Mortgage principal:** The amount of the loan
- **Interest:** The amount you pay for borrowing the money
- **Blended payments:** The "regular" payments made toward the principal and the interest
- **Amortization period:** The period of time over which the calculation of the size of the required payments is based
- **Mortgage term:** The time period over which you agree to make payments to your lender under certain conditions — for example, at a specific interest rate

Mortgage principal

The total amount of the loan you get is called the principal. So if you need to borrow $150,000 to buy a home, then your principal is $150,000. The principal will become smaller and smaller as you pay off the loan.

Interest

Interest is the money you pay a lender in addition to repaying the principal of your loan — a sort of compensation so your lender profits from giving you a loan. The interest rate, calculated as a percentage of the principal, determines how much interest you pay the lender in each scheduled payment — the cost of borrowing the money.

People like to buy homes when interest rates are low because they can either buy a more expensive home than if the rates were higher or pay off the mortgage more quickly. For example, at a 5 percent interest rate, a $100,000 principal would cost you approximately $5,000 in interest each year. At a 7 percent interest rate, you would pay approximately $7,000 a year. That's a difference of $2,000 a year that would go to paying off your principal in the low-interest-rate scenario rather than being gobbled up by interest.

Each lender will have subtle differences in how much extra money you may put against the principal (prepayment options), with different payment schedules offered, and most importantly, they will give you a discount on the posted rates if and when you convert your mortgage into a longer, fixed rate. Do your research before you commit to a mortgage — you have lots of options.

The way your lender adds up the interest you owe has a big impact on the amount of interest you pay over the life of the mortgage. If interest is compounded or added to your balance owing every day, you will pay more over the lifetime of the mortgage than if interest is compounded semi-annually. Most mortgages are compounded semi-annually, but your lender may offer you other options.

Fixed rate mortgage

Because interest rates rise and fall, some times are better than others for taking out a mortgage. To give yourself some stability, you can choose a fixed rate mortgage that allows you to lock in at a specific interest rate for a certain period of time (the mortgage term). If interest rates are rising, you may want to lock in at a fixed rate so you know what your monthly costs will be over the term of your mortgage. When a mortgage term expires, you can renegotiate your interest rate and the length of time (term) that you will make payments at the new rate. As you shop for mortgages, you can see that each lender specifies a certain interest rate for a certain term: Under most market conditions, the lower the fixed interest rate, the shorter the time period you can lock in to pay that rate. However, a longer term, fixed rate mortgage allows you to put a dent in your principal before facing the possibility of an increase in your monthly payments. Take a look in the financial pages of the weekend newspaper or mortgage rate Web sites and you'll see a chart of mortgage rates that will look something like Table 1-2. The fixed rate mortgages in Table 1-2 range from six months to six years. The six-month to six-year options you see are all fixed rates.

Fixed rate mortgages are offered with a variety of options, such as different prepayment options and weekly, biweekly, or monthly payment schedules, so make sure you talk to several lenders (or a mortgage broker) to see who offers the most competitive interest rate and terms.

Table 1-2 Mortgage Rates

Banks	*Variable Rate*	*6-month*	*1-yr*	*2-yr*	*3-yr*	*4-yr*	*5-yr*	*6-yr*
Banks "R" Us	3.50	4.65	3.90	4.05	4.20	4.35	4.50	4.67
Mr. Bank	3.45	4.70	4.40	4.60	4.90	5.10	5.25	5.75
Mortgage Trust	3.50	4.65	3.95	4.25	4.30	4.50	4.75	5.25

Variable rate mortgage

Canadian chartered banks report that up to half of all mortgage applicants now take out variable rate mortgages. A variable rate mortgage is a closed mortgage (usually set up with a one- to seven-year fixed term) where the interest rate fluctuates with the market. If you (the borrower) see that interest rates are starting to rise, you can usually lock into a fixed rate for the balance of the mortgage term. The first option you see in Table 1-2 is a variable rate mortgage.

However, not all variable mortgages are created equal. If you want to lock in to a fixed rate for the balance of the mortgage term, some banks may charge a penalty, or dictate that you must lock in for at least another three years, no matter how much time is left on the original mortgage term. Other credit unions may be totally flexible and allow you to lock in to a fixed rate any time during the original mortgage term with no penalty and no requirements to extend the mortgage. It pays to shop around.

The interest rates of variable rate mortgages will vary from lender to lender, but most will be offered in some relation to the prime rate, which is the interest rate banks charge their most creditworthy borrowers (that is, the big corporate clients). Rates for variable mortgages will usually vary from half a percentage point below prime to half a percentage point above prime. The borrower should also make sure he or she is comparing the same prime rate — some lenders will list a variable rate mortgage at half a percentage point above the well-recognized and respected Bank of Canada prime rate, while other lenders will offer a rate one-quarter of a percentage point below "Bank of Bumpf" prime. This may be an elevated prime rate, which of course means their rate is no bargain at all.

Another factor to consider is a teaser rate — an initial low rate for the first few months (sometimes up to the first year!) that entices borrowers with a snappy slogan such as "1 percent mortgage now available!" However, after the initial teaser period expires, the mortgage will revert to a rate that fluctuates in relation to the prime rate the bank is offering. You have to make sure the mortgage still makes sense after the teaser rate is calculated into the rate of the mortgage. If the teaser is only for three months of a five-year term and the balance of 57 months is at a relatively high rate, the "1 percent mortgage" is actually a rip-off. In this case, you would be better off getting a variable rate mortgage with a competitive rate in relation to prime, with no penalty or restrictions to lock in if rates jump during the term of the mortgage.

Variable rates are not for everyone — you'll need to keep track of interest rates to make sure you lock in your mortgage rate before interest rates rise. It involves a bit of a gamble, but the payoff can be a lower interest rate if you're prepared to watch interest rates and monitor when to lock them in.

Changing from a variable rate mortgage to a fixed term during the life of your mortgage doesn't make good sense. If rising rates are causing you concern and you switch, you'll be switching into a much higher interest rate and payment. With a variable rate, you're in for the long haul or not at all. The choice between a variable and a fixed rate mortgage is also a lifestyle decision. With a variable rate, you can usually buy more of your home with a smaller payment and save interest costs, but if you tend to look in the paper each week and worry about rising rates, think again. You may lose all your interest savings to the medical costs associated with interest rate stress!

If you use a mortgage broker, or get to know your bank's loans officer very well, he or she may call or e-mail you to let you know that a jump in interest rates is looming. If you get that call, you can then decide whether you want to lock in the balance of your variable mortgage or float with the fluctuations in the interest rates. Any rise in rates may be temporary, and you have to decide (with the input of your lender or mortgage broker) whether to lock in your rate. You'll soon determine how well you handle stress, uncertainty, and risk.

Also, find out about escape options. If you pay out this mortgage early (before the third anniversary), what penalty will be charged?

Blended payments

Mortgages are set up so you get a huge chunk of cash to buy your home and then you repay the money in regularly scheduled payments. In effect, each mortgage payment you make is split: One portion goes toward paying off the principal and the other portion goes toward paying off the interest. Hence, blended payments.

Every time your lender compounds the interest you owe on your loan, your monthly blended payment changes. As you pay down your principal, the actual amount of your payment does not change but the portion of the payment going toward the principal increases and the amount going toward interest slowly decreases.

If your mortgage is $100,000 (with a 5 percent interest rate compounded semi-annually) to be paid over a period of 25 years, your monthly payments will be approximately $585. Table 1-3 illustrates this.

Table 1-3 Breakdown of Blended Payments

Timeline	*Your Monthly Payment of $585*		
	Principal	*Interest*	*Balance Principal*
1 month	$168	$417	$99,895
6 months	$171	$413	$98,982
1 year	$176	$409	$97,938
5 years	$2,517	$4,498	$88,580
10 years	$3,231	$3,784	$73,924
20 years	$5,321	$1,694	$30,977

You can see that as you pay down the principal, the distribution of your payments changes. Gradually you begin paying more money toward the principal than toward the interest you owe to your lender.

The more frequently you make mortgage payments, the faster you pay down your principal, which means you eliminate your mortgage faster and pay less interest. Payment schedules can be arranged monthly, semi-monthly, biweekly (every two weeks), or weekly. Arrange with your lender to make payments as often as you can reasonably manage. If you can make weekly payments rather than monthly ones, you'll save thousands of dollars over the lifetime of the loan. Table 1-4 illustrates how making more frequent payments can really whittle down the time it takes to repay a mortgage.

Table 1-4 Mortgage Payment Frequency Comparison

Calculations for a 25-year $200,000 mortgage at 5 percent interest, compounded semi-annually

Payment Options	*Monthly Payments*	*Years to Repay Mortgage*
Monthly	$1,169	25
Biweekly	$609	20
Weekly	$339	19

Mortgage term

A mortgage term is the specific length of time you and your lender agree the mortgage will be subject to certain negotiated conditions, such as a certain interest rate. Terms range from 6 months to 10 years, but occasionally a lender will offer a 15- or 25-year term.

At the end of the term, you generally have the option to pay off your mortgage in full or to renegotiate terms and conditions. If interest rates are ridiculously high, you will probably want to negotiate a shorter term and then arrange a longer term when rates are more favourable. If interest rates are deliciously low, lock in for the longest term you can negotiate. At the end of your mortgage term, you can also transfer your mortgage to another lender who may offer you a better rate, at no cost to you.

Mortgage-a-rama: All the Nifty Options

Depending on how much of a down payment you can make, you will be eligible for either a conventional or a high-ratio mortgage. If you can bankroll a conventional mortgage, then you have at least 25 percent of the money needed to buy a new home. If your savings leave you with a less than 25 percent down payment, then you qualify for a high-ratio mortgage. No matter which financial position you find yourself in, you still have a number of mortgage options to choose from.

Before you sign on the proverbial dotted line, you need to know your mortgage payment options. You'll find open mortgages, closed mortgages, and mortgages that offer something in between. Whichever option you choose affects how much money you pay over the lifetime of the loan and the flexibility of the terms. Some mortgages allow you to pay off your principal in lump sums as you wish and prepay your principal without any penalties. Other mortgages allow you to prepay only once a year on the anniversary date of the mortgage, or there may be no possibility of prepayment at all.

- **Open mortgages are flexible.** If you have an open mortgage, you can pay it off in full or in part at any time with no penalty. By chipping away at your principal early, you can save crazy amounts of money in interest. Of course, every penny you save in interest is a penny that doesn't get into your lender's hot little hands. That's why the average fixed interest rate quoted for an open mortgage is 0.4 to 0.6 percent higher than a closed mortgage for the same term (a specified period of time). The majority of open mortgages with a fixed interest rate are available only for a short term. Most variable rate mortgages have a fixed five-year term, but may be open after three years, and as you can see in Table 1-1, variable rate mortgages are usually offered at a lower rate. An open mortgage is a good choice if you're going to move again soon, if interest rates are expected to plummet, or if you're expecting a huge cash windfall when oil is discovered in the scrubland you bought near Medicine Hat. This kind of mortgage is good for the short term when rates are high, and it can usually be converted to a closed mortgage at any time.
- **Closed mortgages are more stable.** The advantage of signing on to a closed mortgage for a term, or specified period of time, is that you will typically get lower interest rates and you will be able to budget for fixed, regular payments. The downside is that if you need to move before your term is up, or if you have extra cash, such as an income tax refund, which you'd like to put toward paying off a large portion of your principal, you may pay a penalty for this privilege. Most closed mortgages will give the borrower the ability to prepay 10 to 20 percent of the outstanding balance without penalty, often on the anniversary date of the mortgage. In some cases, there may be restrictive conditions that will make getting out of your mortgage an expensive proposition. You may face a prepayment penalty or rate differential fee if you want to discharge the mortgage before the end of the closed mortgage. Read the fine print and ask lots of questions.

Different financial institutions offer a range of mortgages involving different degrees of flexibility for prepayment. Even most closed mortgages have some prepayment options. You can make specified maximum prepayments, usually between 10 and 20 percent, once a year either on any payment date or on the anniversary date of the mortgage, and in some cases you can increase each payment. You're charged a penalty if you pay down more.

Portable mortgages

If your mortgage is portable, you can take it with you to your new home. When you get ready to move, you'll be glad you asked about this option, especially if you negotiated great terms or if interest rates have gone up since you locked in to your current mortgage. Even if you're buying a more expensive home, it's still to your advantage. For example, if you have a $200,000 mortgage at 6 percent interest, and you're in the third year of a five-year term, you can take the mortgage with you to the $375,000 home you want to buy. You will need an additional $50,000 loan to be added to your principal. If the going rate on new loans is 5 percent interest for a three-year mortgage to match the remaining three years of your five-year term, you'll need to negotiate a blended rate on the new amount. The blended mortgage payment will be composed of two parts: your initial payment toward your $200,000 mortgage plus the second payment toward the additional $50,000 mortgage. Remember that your payment will be the result of "blending" two mortgage rates, and of course your monthly payment itself will consist of interest and principal components.

Assumable mortgages

When you're buying a home, in addition to contacting financial institutions about mortgages, you may want to ask the sellers if they would allow you to take over their mortgage as part of the price you pay for the home. This option is quick and it may save you some costs usually associated with setting up a mortgage, such as legal, appraisal, and survey fees. It may also save you money in interest payments if the seller's mortgage rate is lower than what is currently available on the market. Do check the remaining term on the mortgage and discuss this option with your real estate agent or your real estate lawyer.

Having an assumable mortgage on your home means that when you want to sell it, you can have a qualified buyer assume the mortgage. This is a great incentive if you have good terms and conditions, and it saves the buyer time finding financing and money setting it up. Most mortgages are assumable as long as the buyer can qualify for the mortgage amount.

You can still expect to go through some financial examination even if you're assuming the seller's mortgage. The lender will want to ensure you meet the mortgage requirements. See "The information game: What your lender wants from you" in this chapter for more on supplying personal and financial information to your lender.

Vendor (seller) take back mortgages

A less common type of mortgage, especially when the housing market is going strong, is the vendor take back (VTB). It's sometimes used if the sellers are anxious to move, for example, or if the market is really sluggish, or if the sellers are looking for a good investment when they get their equity out of the home. In each case, the sellers may offer to lend you the money for your mortgage. This is called a vendor take back mortgage. The sellers may offer you lower rates than big financial institutions will, and they won't require the appraisals, inspections, survey fees, and financing fees you would expect to pay a traditional lender. This type of mortgage can get very complicated, so you'll want to have your lawyer draw up the papers to guarantee everything is in order. Some people will sell buyers a mortgage and then pass it on to a mortgage broker to handle instead of dealing with it personally.

Builder/developer interest rate buy-down

If you're in the market for a new home, you may find builders and developers willing to offer mortgages with an interest rate buy-down. This may take the form of a vendor take back mortgage where the builder/developer will lend you the money, or more commonly, the builder may buy down the interest rate of the mortgage you are getting from a bank — usually by 2 or 3 percent. This explains those newspaper ads for projects and subdivisions for sale with 3 percent mortgages.

The goal of the interest rate buy-down is to sell real estate. The buy-down will help a buyer who is having trouble qualifying for a mortgage at current rates, or allow a buyer to qualify for a larger mortgage and therefore buy a more expensive property in the development. Keep in mind, however, that these mortgages are typically not renewable. This means that when the term is up, your mortgage rate, and therefore your monthly payment, is likely to climb significantly.

After that mortgage term is up, you need to negotiate new terms and find a new lender — usually a bank or a credit union. Naturally, your lender will do an appraisal of your property. You're expecting this. What you're perhaps not expecting is that your new lender may appraise your one- or two-year-old house at several thousand dollars less than the price you paid for it. Here's why this happens: Builders want to offer reduced interest rates as an incentive

to buyers. However, they're still protecting their bottom lines, so to compensate for offering lower interest rates they incorporate the cost of the buy-down into the price of the home itself. This means you pay a larger principal on the builder's inflated price of the home.

The solution? Arrange a mortgage with a financial institution and ask the builder or developer to buy down the interest with your lender. This way, you can take advantage of the deal on the interest rate and still have the option to renew your mortgage with your lender at the end of the term. Another option is to take your mortgage at market rates and ask the builder to lower the selling price accordingly.

"Can I have a mortgage with that, please?" Like car dealers, sellers can really sweeten the deal by helping you put the financing in place — an option that could save you a lot of money. This is the case with the last three mortgage options addressed: assumable mortgages, vendor take back mortgages, and builder/developer interest rate buy-down. But buyer beware: Read the fine print and consult with your agent or lawyer before accepting any seller's mortgage offer — it might just be too good to be true.

Zero down payment

It sounds like one of those shows you see on TV at 1 a.m. — buy your dream home with no down payment! It may be hard to believe, but a few years ago, the Canada Mortgage and Housing Corporation changed its policies to allow you to buy a home with no down payment. The "zero down" mortgage program was introduced to give buyers more options — especially buyers who have a good income and a good credit history, but limited savings. Many banks will actually give you the 5 percent for the down payment based on your committing to a five-year fixed mortgage at the bank's five-year posted rate. The zero down mortgage can also be an option if you do have the money for a down payment but prefer to use it to pay down debts such as credit cards and car loans.

Be sure to take care if you're considering this option: These mortgages aren't for everyone. Remember that this is a huge loan, because the smaller the down payment you make, the more money you'll have to pay off over the years. Plus, you need to fit certain criteria to qualify. Most lenders will require buyers using this program to have an excellent credit rating and a very secure job. Some prefer that the buyer has a few months' worth of savings, or some money invested in something like a retirement plan. But what's great about the program is that it allows people who have good incomes, but who haven't had the chance to build up a down payment, the chance to become homeowners.

On the flip side, you just have to look south of the border to see what happens to homeowners who needed little more than a pulse to get a loan. These highly leveraged homeowners bought properties at high prices and then saw

their home values plummet. To add to their burden, when these low-rate mortgages were "reset" to higher market rates, more of the blended payments went toward interest. This meant a slower mortgage paydown. To this day, hundreds of thousands of Americans are walking away from (or are unable to pay for) their large and very long-term mortgages!

Not all lenders are promoting the zero down program, so it may take a little shopping around to find the right banker or mortgage broker who is comfortable with the program.

You've heard about the sub-prime mortgage crisis in the news — it's commonly referred to as the credit crunch. Not totally sure what it's all about? Essentially, a credit crisis is causing an ongoing and steep rise in mortgage foreclosures, or defaults — many homeowners can't meet their payments anymore. Banks are going under, too. The whole mess began in the United States in mid-2006 and has spread to Canada and globally. Many factors created the crisis, but foremost was a period of rising interest rates. (Too many creative mortgage brokers fudging things didn't help, either.) People who had adjustable rate mortgages — essentially, variable mortgages — now had to pay more, often also over a longer period of time. Watch interest rates closely. If they keep moving up be very wary of this type of risk, and make sure your job is safe and your financial condition sound before you commit. Buy only what you can afford!

Line of credit

It's becoming more common to buy a property using a line of credit instead of a conventional mortgage. Buying your home with a line of credit works a bit like using a credit card. You will need to make a minimum monthly payment, but that payment only covers the interest — it won't pay down the principal, or the amount of the loan. Anything else you pay beyond that monthly payment is up to you. To reduce the outstanding balance of the line of credit, however, you must pay more than the minimum monthly payment or the principal won't be reduced.

The benefits of the line of credit are

- Lower monthly payments (should you choose to pay just the minimum)
- Total flexibility paying off the outstanding balance of the loan — with a regular mortgage, you can't change your monthly payments at will

The downsides of buying with a line of credit are

- At the minimum payment, no reduction in the outstanding balance
- Rate fluctuates with prime, meaning it's not fixed (for example, at the prime rate or .25 percent or .50 percent over prime)

If you're someone whose income fluctuates, with occasional high-income months, this option might be right for you. To qualify you will need to have a higher down payment (at least 25 percent) and a very good credit rating. It will take some time and analysis with your bank or mortgage broker to determine if it's something that will work well for you, as opposed to a conventional mortgage.

Mortgage Insurance

As you already know, mortgages are a big deal. If you have a high-ratio mortgage, your lender will require mortgage loan insurance from the Canada Mortgage and Housing Corporation (CMHC). A public company called Genworth Financial, which used to be GE Capital Mortgage Insurance, also offers mortgage insurance at about the same rates as the CMHC. To decide which you might use, visit their Web sites (`www.cmhc-schl.gc.ca` and `www.genworth.ca`) and talk to your lender. Mortgage insurance covers your lender in case you default on your payments. You may also choose to purchase mortgage life insurance. This way, if something happens to you, your mortgage payments will be made by the insurance company and not be a burden on your family (see "Mortgage life insurance" in this section).

High-ratio mortgage insurance

If you have a down payment of less than 25 percent of the purchase price of your home, then you're eligible for a high-ratio mortgage. However, lenders will require you to have mortgage insurance so that their risk is protected. The high-ratio insurance is arranged by the lender. Because of the credit crunch, this type of insurance is more expensive and less attainable than ever before.

How to qualify for high-ratio mortgage insurance

Many buyers have high-ratio mortgage insurance coverage through the Canada Mortgage and Housing Corporation. An alternative is Genworth Financial. Both institutions have four standard eligibility requirements:

- The home you're buying will be your principal residence.
- The home you're buying is in Canada.
- Your gross debt service ratio is not more than approximately 32 percent. In other words, the total you spend on housing (including principal and interest, property taxes, heating, and 50 percent of condo fees) is not more than approximately 32 percent of your gross (pre-tax) household income.
- Your total debt service ratio, including any car loans, student loans, and credit card debt, is not more than 40 percent of your gross (pre-tax) household income.

Investors buying an investment property that will not be their principal residence can also get a high-ratio mortgage, but the insurance premium will be higher — up to 6 percent of the mortgage amount — and you must have a down payment of at least 15 percent.

What high-ratio mortgage insurance will cost you

The premium for high-ratio mortgage insurance is typically 0.5 to 3.50 percent of the mortgage amount, determined by a sliding scale. If you're taking out a variable rate mortgage, be prepared to pay an additional 0.25 percent insurance fee. The CMHC also charges a fee to process applications. The fee is $165 if the application is processed through the emili system (an online mortgage approval system used to process loan applications) and $185 through FAXemili (the fax option). For Genworth high-ratio mortgage insurance, the fees are similar — the premium can be anywhere from 0.50 to 3.50 percent, depending on how much you pay for a down payment. The fee for processing can vary, too, anywhere from $75 to almost $200 depending on your specific mortgage.

Be sure to ask about incentives for you, the borrower, if you buy an energy-efficient home, or borrow money to make more energy-saving renovations to an existing home. You might qualify for as much as a 10 percent refund on your mortgage loan insurance premium.

Mortgage life insurance

Mortgage life insurance guarantees your mortgage will be paid in full if you die. Some lenders offer this insurance and will add the premium to your mortgage payments. It's still a good idea to shop around through an insurance broker for the best rates, though. Also check your employee benefit plan to see if this type of coverage is offered. You may want to get insurance coverage for all parties responsible for the mortgage (for example, if your home is in your name and your spouse's, both of you should be insured).

The lender may offer insurance where they will pay off the balance of your mortgage upon your death. This is commonly referred to as declining balance insurance. However, you may also want to consider regular term insurance. The premiums should be comparable to declining balance insurance, but this policy covers you for the full amount of your mortgage should you pass away — not just the outstanding balance.

Who Ya Gonna Call?

You can shop around for a better mortgage rate. You can start with your local bank, but you don't need to have an account with an institution to qualify for a mortgage there. And there's no reason to limit yourself to banks and trust companies in your mortgage hunt. Credit unions, caisses populaires, and pension funds also supply mortgages, and many don't require that you be a member in order to be eligible. You can also look to insurance companies, finance companies, and private lenders.

Mortgage brokers can also be a useful resource. Although mortgage brokers often start by checking with the major banks, they are not affiliated with any particular institution; they can match you with the lender who gives the best terms and rates for your situation. In addition to banks, trust companies, credit unions, pension funds, and private lenders, mortgage brokers can access real estate syndicates and foreign banks. The lender typically pays mortgage brokers a finder's fee (a percentage of your mortgage). However, if your credit history is particularly spotty, you may be asked to pay a fee to the mortgage broker and/or lender. You can peruse different Canadian mortgage brokers on the Internet.

The information game: What your lender wants from you

After you've become intimate with your financial life and the world of mortgages, it's time to cozy up to your lender — often known as "the bank." Basically, your lender needs two things from you — detailed personal information and paperwork. Don't take the probing questions personally. Everyone goes through the same process, whether it's Elizabeth R., Queen of England, or Gaia Sandalfoot, just off the commune.

Tell us about yourself

Prospective lenders want to know all about you. They'll ask about your financial status and employment as well as your personal information and history. Expect questions like these:

- **What is your age, marital status, number of dependants? Where do you work? What is your position? How long have you been with the company? What is your employment history?** Unless you're self-employed, you will probably need a letter from your employer confirming your position with the company. If you are self-employed, bring your tax assessments (not your tax returns) from the past two years to confirm your earnings.

- **What is your gross (pre-tax) family income?** You may need proof of income like a T-4 slip or, if you're self-employed, personal income tax returns. You will also be asked to show proof of other sources of income from pensions and rental property.
- **What do you currently spend on housing?** If you're a homeowner, what is the current market value of your home? You may have to provide copies of your rental lease agreement for the apartment or suite you're renting or a copy of your current mortgage.
- **Do you have funds for a down payment?** The lender wants to ensure that your down payment will be available when you need the money to close on your purchase. The lender will want to see where your down payment is coming from — is it sitting in the bank or will it be coming from your beloved Aunt Bibi in the near future? Perhaps it's coming from your RRSP with the special Home Buyers' Plan designed only for first-time homeowners. (We discuss this plan in Chapter 4 of Book VI.) Under the new CMHC guidelines, you can buy a property with no down payment (we discuss this option earlier in this chapter), and the guidelines for getting your down payment as a gift have been relaxed, but you will still need to satisfy the lender that money will be available for completion of the sale.
- **What assets do you have and what is the value of each one?** You can include vehicles, properties, and investments such as your RRSPs.
- **What liabilities do you have?** You can include credit card balances, car loans, student loans, and lines of credit.

Lenders will also ask your consent to do a credit check. A credit check may give you a good or bad credit rating depending on your financial history. We recommend you contact a credit-reporting agency, such as Equifax Canada or your local credit bureau, to obtain a copy of your credit report. (You can also do this online at `www.equifax.ca`.) Examine it in detail. If you find inaccurate or outdated information in the report, you can have those items corrected or removed to make your credit rating as glowing as it can possibly be.

Let's have it in writing please: The paperwork

Most lenders can pre-approve your mortgage over the phone. You may have to fax them the required paperwork, and in return they will fax you a written confirmation outlining the terms of your mortgage pre-approval. Often you will not meet your loans officer until you receive the seller's acceptance of your offer to purchase their home, and you're ready to seal the deal by finalizing all the financing.

Getting all the papers together for a mortgage is just the beginning of a long paper shuffle you will be doing until you finally get the keys to your new home. Be prepared with the following documents when you meet with your lender:

- Copy of a recent appraisal for the home you're buying (if requested — the bank may already have ordered it for you)
- Copy of the property listing
- Copy of the Agreement of Purchase and Sale (for a resale house)
- Plans and cost estimates if you're buying a new house (construction loans only)
- Certificate for well water and septic system (if applicable)
- Condominium financial statements (if applicable)
- Survey certificate
- Property disclosure statement (signed by both parties) or condominium certificate (if applicable)
- Engineering inspection report

Changing places: Questioning your lender

Just because you're the one requesting money doesn't mean you can't ask questions. Lenders profit from your business, so don't be afraid to bring up your concerns. Expect to be answered directly in a courteous manner, and reply to your lender's questions in kind. Keep a list, and have paper with you to use in meetings or on the telephone so you can be sure to cover all the bases.

Stay cool and calm as you chat with prospective lenders. Remember, you're shopping for a mortgage, not begging for one. Keep this list handy to be sure you ask the right questions:

- **What is your name, title, and phone number?** Start with the basics.
- **Do you comply with all the provisions of Canada's privacy legislation?** In case you're wondering whether your information will be kept confidential, don't worry. In Canada, the Privacy Act and the Personal Information Protection and Electronic Documents Act (PIPEDA) are two federal laws that forbid lending institutions (and other businesses) from disclosing your private information. For more details about privacy legislation, you can visit `www.privcom.gc.ca/index_e.asp`.
- **What mortgage types and terms do you have available? Do you have any that are specifically designed for my situation?** Many major banks have special offers for first-time homebuyers, for example.
- **What are your current mortgage rates?** Compare the rate offered on closed mortgages to the rate offered for open mortgages. An open mortgage gives you more flexibility and can save you money, but usually has a higher interest rate than a closed mortgage, as we explain in this chapter.

- **How are you making your mortgages competitive with other lending institutions? Are any discounts or cash-back options available?** Some lenders lower their interest rate a bit if you ask nicely or show them lower rates from the competition; other lenders offer you a percentage off your mortgage upfront — usually between 1 and 3 percent as a cash-back program — to help you with your closing costs.
- **What mortgage fees do you charge? Is there a mortgage application fee?** Make sure you know what kind of costs your lender expects you to cover.
- **Do you pre-approve mortgages? Is there a fee for this?** Most institutions do not charge a pre-approval application fee.
- **How long will it take to process my loan request? After it is approved, how long should I allow before I close the deal?** When you set your closing dates for the purchase of a new home, the schedule for your transfer of funds is crucial. Know what to expect.
- **How is the interest compounded?** Most lenders compound interest semi-annually (every six months). Ask if your lender offers any other compounding options that may save you money.
- **Can I convert from a variable to a fixed rate mortgage?** As we explain in this chapter, if you choose a variable rate mortgage (VRM) you're vulnerable to fluctuations in the current interest rate. When interest rates rise you pay higher mortgage payments; when rates fall you pay less. You want the option to convert your VRM to a fixed rate mortgage if interest begins to climb significantly.
- **What are my payment options?** As we detail in this chapter, make payments as often as you can to save yourself a lot of money in the long run — weekly is best.
- **Can I pay off the mortgage early? Is there a penalty for this? Can I pay down some of the principal without penalty? How much a year? Can I double my payments?** You also want the option to make an extra lump sum payment toward your mortgage principal at least once or twice a year to help you save on the interest.
- **Is mortgage life and critical illness insurance available with your mortgages? Will they cover both my partner and me?** You want to protect your family members in case something happens to you. But check the cost. A separate insurer may offer lower insurance premiums for the same coverage.
- **If my credit rating is not acceptable at this point, what can I do to improve it? Or what options do I have?** Be prepared: Any lender who offers mortgages will check your credit rating.

Chapter 2

Discovering Your Perfect Home

In This Chapter

- Rounding up your home-buying posse
- Knowing what you want in a home
- Finding home listings online
- Uncovering homes for sale

Close your eyes (okay, don't really close your eyes until you've finished reading the rest of these instructions), lean back, put your feet up, and picture your ideal home. Maybe it's a century-old Victorian manor with turrets and a coach house. Maybe it's a modernist square, with kilometres of skylights and orderly gardens. Maybe it's a condo with a view of the park, a huge balcony, an on-site tennis court, and a bowling alley. Got a good picture of it? Excellent. Take a mental snapshot — it's probably the only way you're going to see that home.

Yes, most of us have to settle a bit. But if you're old enough to buy a home, you're probably familiar with the fine art of compromise by now. This section helps you to prioritize what you need, what you want, and what you'd be really lucky to find. We also offer advice on where to look and what to look for, as well as tips on discriminating between real and imagined benefits, and not-so obvious drawbacks.

Selecting Your Home-Buying Team

You're taking a really big step when you decide to purchase a home — especially if it's a house. Fortunately, lots of experienced people are around to help. Do yourself a favour and pick a good team. Don't be afraid to ask a lot of questions and shop around until you find professionals you have confidence in and you can relate to. In this section, we talk about some of the key players on your home-buying team.

Your agent

Lots of real estate agents will want to work with you. Make sure you find one you want to work with. You will rely on your agent for information and advice about your specific situation. Your agent deals with the sellers, negotiates for you, and advises you throughout the process. Try to find someone who speaks your language . . . literally and figuratively.

In brief, what you're looking for in an agent is someone who has the following:

- **Knowledge:** Your agent must be familiar with the neighbourhoods you like and the style and price range of home you are looking for.
- **Experience:** Your agent should be someone who has worked with clients like you before, who knows how to help you buy the home you want for a fair price, and who can anticipate problems before they come up.
- **Time:** Your agent must be willing to spend time to give you the support and direction you need . . . when you need it.
- **Contacts:** Your agent should have colleagues and advisers to call in when you need financial advice or assistance, legal work, appraisals, and so on.
- **Ethics:** Your agent should always have your best interests in mind. Don't take this for granted.
- **Established broker/office manager:** Your agent relies on the backup of a respected and well-connected broker who is often also the office manager. If a serious problem arises, you'll rely on this indispensable person too.
- **Internet skills:** Your agent should be able to search listings on the Internet and be readily available via e-mail. See "Home Shopping Online" in this chapter for more on the Internet.

Understanding your relationship with your agent and the broker/manager

We know, you thought you had your work cut out for you just understanding the relationships you already have in your life. Well, the relationships among you, your agent, and the agent's broker can be no less confusing. But help is on the way! In this section we take you through the ins and outs of what an agent and a broker do, and then talk a bit about the different types of agents out there.

- **Real estate agent (also sometimes referred to as salesperson, Realtor, representative, or sales representative):** Subcontracted by broker to work on behalf of buyer or seller or, very rarely, both
- **Broker or managing broker/nominee:** Legal "agent" who works on behalf of buyer or seller or both; usually serves as office manager overseeing daily operations and also reviews all transactions

When you decide to work with a real estate agent, you are effectively engaging the services of the agent's broker as well, regardless of whether you meet that individual. The broker is the person you can turn to if things go terribly, terribly wrong and your agent can't manage the situation. A skilled broker is able to call in favours if bureaucratic roadblocks or procedural questions arise or if your home purchase spirals into one of the rare legal disputes that can happen when closing a real estate deal. As we mention earlier, the broker is the action hero with all the tools and influential friends to stay one step ahead of the game and save the day.

Note: Some real estate agents also have the qualifications to legally call themselves brokers, but they tend to use the more commonly understood term of agent or even representative. In many provinces, a broker's (or managing broker's) licence requires additional training and testing and a licence designation beyond that of a salesperson. With this extra education, an individual can own a brokerage or run an office (be the "nominee" for the office) and ensure that the salespeople and all of the office's trust accounts adhere to the requirements of the provincial Real Estate Act.

A broker or brokerage company, and by extension a real estate agent, may be a seller's agent or a buyer's agent. In some cases, real estate agents working for the same broker will represent both the seller and the buyer in a deal. Dangerous conflicts can arise, so watch every move in this case. Although each party has its own real estate agent, because both agents work for the same broker or legal agent the situation is referred to as dual agency. The agent you are working with to find a home may show you a property that is listed with his or her office. If you buy the property, you will have to agree to enter into a limited dual agency agreement.

Another term you'll encounter is Realtor. This is a trademark of the Canadian Real Estate Association (CREA). Only brokers and real estate agents who are CREA members may use this term to describe themselves professionally. Extensive training and continuing education are required. Realtors also follow a very strict code of ethics and standards of business practice designed to protect your best interests.

The rules and regulations governing agency relationships vary a bit from province to province. Ask your local real estate board or your provincial real estate council for specifics. In general, agency relationships break down as follows.

Seller's agent

When real estate agents are seller's agents they owe full loyalty to the seller and must give them all available information and take every action to obtain the highest price and best conditions of sale for the sellers. Don't expect the seller's agent to tip you off to the fact that a seller is anxious to move and would probably accept $10,000 less than the asking price. And if you meet a seller's agent at an open house, be discreet. If you say you're going to put in a

bid on the home at $10,000 less than the asking price, but you're willing to pay full price in order to get into the neighbourhood, the seller's agent is legally obliged to disclose that information to the seller. Remember the one point in your favour: The seller's agent also has a legal obligation to tell you, the buyer, if he knows of any serious problems with the home being sold. Expect honest, complete answers to your inquiries.

Buyer's agent

Surprise, surprise — a buyer's agent works in the best interest of the buyer. Even though your buyer's agent's commission is usually paid out of the seller's proceeds from the sale, her legal and ethical duties are to you. Your buyer's agent should keep your personal and financial information confidential. If the sellers let slip that they're going through a messy divorce and want to sell the house as soon as possible, your buyer's agent will share this information with you. She'll also let you know if she finds out the sellers are willing to accept a lower price. Your buyer's agent also helps you determine how much you can spend on a new home and how much is reasonable to offer on the homes you're considering. A buyer's agent negotiates the best deal possible on the buyer's behalf, ideally the lowest price and best conditions for you, the buyer.

Dual agency

If both the buyer's and the seller's agents work for the same broker or brokerage company, this is called dual agency. One company is brokering a deal between two parties, and it legally represents both sides. This situation can open up a number of conflict-of-interest concerns.

To head off any problems, the broker is legally obliged to tell you and the seller that she (or her company) is representing both the buyer and the seller. Ask the broker to explain clearly what the implications are for the sale negotiations. You will be asked to accept the dual agency situation in writing. If you're unsure what to do, contact your local real estate board for clarification. Although both agents may work out of different offices and not know each other, if they work for the same company they must also acknowledge in writing that they are in a dual agency situation.

Choosing an agent

When you choose a real estate agent, look for someone who will work hard for you. Someone who asks questions to clarify what you need and what you want is kilometres ahead of someone who tries to *tell* you the same information. The best agent will be curious about you, your family, your finances, and your future plans. Someone who asks questions and listens to your answers will serve you far better than someone who takes charge and tells you what you want. Your agent should respect your time and independence; a good

agent will provide you with all the information you need, and give you room to make your own decisions. The best client–agent relationship results when the agent and buyer have similar temperaments in terms of enthusiasm, sense of humour, and energy level.

Select an agent who works primarily in the community or area where you want to live. Real estate agents have in-depth knowledge of neighbourhoods, selling prices, schools, property tax and utility rates, local amenities, and civic issues.

Choose a full-time agent over one who works part time. The real estate market changes constantly and part-time agents just won't be able to keep up with new listings and market activity. A full-time agent not only stays more in touch with the market, but also is more familiar with the paperwork involved.

Be sure your agent is familiar with the use of the Multiple Listing Service (MLS). Most agents have access to MLS. This is a database of all currently listed properties that makes it easy for agents to run a search for properties that fall into your price range and offer the amenities you are looking for.

The Web can be a great help in your search for an agent. First, you can access real estate Web sites to find someone who's right for you; look through the agency's home listings online to find the person representing homes that are similar to your own. Then, when sizing up prospective agents, look for one who is Internet savvy. He or she can access MLS listings on the Web and e-mail them to you, saving you many phone messages, trips to the agent's office, and fruitless home visits.

Taking referrals into account

If possible, use an agent recommended by a friend, relative, business associate, or someone else you trust. If the agent provided good service to that person, chances are you'll get good service too.

Speaking to a head broker at a major real estate company may be extremely helpful. Even if you're moving cross-country, chances are the broker will have a list of contacts for agents working in particular areas, as well as agents who deal with particular types of properties. Search the Internet too; `www.mls.ca` is an excellent site that is linked to all real estate boards across Canada and can help you get a feel for prices and neighbourhoods anywhere in the country. Through this site, you may also find an agent active in an area you want to check out.

After you have the names of a few agents, arrange to meet with them. Ask each of them to bring a record of all the houses they've listed and sold in the past year. This way you can verify what kind of homes, neighbourhoods, and

price ranges are most familiar to each agent. You will also figure out quickly whether you get along with the agent. Remember that an agent with good people skills not only will be nicer to work with, but also will represent you well to sellers and will be an effective negotiator when the time comes to make an offer.

Asking the right questions, making the right choices

You're interviewing potential agents for the job of helping you find a home. While it's not actually time for you to get revenge for every job interview you went on that went badly, you can ask these questions when you're interviewing prospective agents. An experienced, reliable agent will have no problem with being put in the hot seat.

- **How long have you been an agent? Do you work full time?** The longer your agent has been in the business, the more you benefit from the wide range of experience.
- **What professional designation do you have? Are you continuing your education?** A dedicated professional strives to update skills and knowledge. To stay current, your agent should have completed at least one course in the previous year.
- **Who do you represent?** Some agents prefer to work on behalf of buyers and some prefer to work on behalf of sellers.
- **How many clients do you have right now, and will you have the time to work with me?** A good agent has an established client list and will be working with a number of buyers and sellers at any time. If you're looking for a specific type of property (for example, a condo with a water view), is the agent working with other people looking for the exact same type of property and will that create a conflict?
- **Do you have access to the Multiple Listing Service (MLS)?** Knowledge of the Multiple Listing Service is an essential tool in the home search process.
- **How many agents work in your office?** Are you working in an active and vibrant office that is up to date on market activity and is aware of new listings as they come on the market?
- **Does your office have an active and attentive manager/broker?** You need to know you have someone to turn to if you and your agent need help with a particularly complicated or unusual circumstance.
- **Will any responsibilities in my home search be delegated to someone else?** You want to know you're going to receive the agent's personal attention. Many busy agents have assistants to whom they will refer potential buyers — make sure you get to work with the agent you're choosing.

- **What neighbourhoods/types of homes do you specialize in?** You probably already know the kinds of properties you're interested in, and you want your agent to be an expert in that particular field.
- **What price range do you deal in primarily?** You have a budget and you need an agent who's skilled at working within that money range.
- **How many people have you helped buy a home in the past year?** You want an active agent who's successful in the current real estate market.
- **How many people have you helped sell a home in the past year?** It never hurts to know the stats on your agent, but the best agent for you doesn't necessarily have the highest number of sales.
- **Can you refer me to real estate lawyers, mortgage brokers, notaries, lenders, inspectors, or appraisers if I need their services?** Any agent with some experience will have a few contacts you can capitalize on.
- **Do you have a list of client testimonials I could look at?** Read over what former clients have to say about your agent. If your agent doesn't have testimonials to read, contact former clients about their experiences.
- **Have you been sued?** Find out how often and why.

Suppose you haven't chosen an agent and you go to an open house and absolutely love the house. What do you do? Remember, the agent holding the open house works for the seller. If you're comfortable with that agent you can ask her to represent you, and enter into a limited dual agency agreement. However, if you're not comfortable with the agent or the concept of a dual agency relationship, you can scramble and find another agent to work with you as your buying agent. You do not have to work with the agent holding the open house unless you want to.

It doesn't matter whom you talk to — the agent, your Uncle Wayne, who referred you to the agent, the senior broker where the agent works, or the agent's most recent clients — don't be shy, and don't let things slip because you don't want to offend anyone. No question is too silly and all questions are relevant. After all, you're trusting your real estate agent to help you make the biggest single investment of your life.

Making your agent work for you

Explain your home-buying requirements to your agent. Bring along your list of household and neighbourhood priorities (see the section "Knowing What You Want in a Home" in this chapter). After the agent knows your needs, tastes, and budget, the fun really starts — you go on tour. Your agent will show you around various homes and neighbourhoods until you decide you've found the one you want. When you're ready, your agent will present

your offer to the sellers. In most cases, your real estate agent will help you negotiate the sale terms and conditions and close the deal for you.

To facilitate the whole sale process your agent should give you referrals (if you need them) to other professionals, including real estate lawyers, notaries, lenders, appraisers, financial advisers, contractors, and inspectors. (There should be a couple of each to ensure favouritism isn't a factor.)

A good agent will be adaptable and creative in order to meet your needs. If you can't visit a house or condo in person, you may be able to arrange for an online virtual tour, or if you're planning a cross-country move, your agent may be able to provide a video tour of some homes.

Your agent helps you best if you are straightforward. If you decide to work with more than one agent, let them both know and tell them why. Because most agents are connected to the MLS system, they will all be trying to show you the same listed homes that fit your price, location, and style specifications. The more agents you work with in one area, the more likely you are to get poor service. We recommend working with one agent whom you trust, who has the time to help you, and who has the personality to make it work than with several semi-committed agents.

Most real estate agents are hardworking, responsible professionals who do everything they can on your behalf. It will probably be really obvious to you if your agent doesn't fall into this category, but just in case, we've compiled this handy list of warning signs that point to poor agents:

- They never point out any problems with the houses they show you.
- They swear up and down the foundation isn't crumbling, even though your 2-year-old has kicked in the corner.
- They show you only houses that are being listed by their company.
- They show you only mansions when you are in the market for a semi-detached.
- They make you feel pressured or bullied.
- They get sued and have to defend themselves in court.

If your real estate agent is (a) too busy, (b) too pushy, or (c) too clueless, end the relationship!

You're in the driver's seat — your agent is supposed to be guiding you into a great deal, not over the edge of a cliff. If you signed a brochure (an acknowledgement of the buyer–agency relationship, not a contract), it doesn't bind you to that agent forever. Call the local and provincial real estate board for

advice on your particular situation. If you signed a buyer's contract with the agent stipulating you would pay a finder's fee to the agent if he finds you a house (as opposed to the usual sharing of commission paid by the seller), make sure the contract has a termination date or a release clause if you want to terminate that agreement.

Don't commit to anything you don't feel comfortable with. You want to buy a home, and you want the process to be as pleasant and hassle-free as possible.

Your appraiser

Your mortgage lender will probably insist their appraiser conduct the assessment of the home you're buying . . . even if you've done your own appraisal before submitting an offer. If this is the case, you have no say in the choice of the appraiser. But chances are the lender's appraiser is both qualified and experienced. After all, a financial institution depends on the appraiser's expertise to decide whether to lend out hundreds of thousands of dollars. Bear in mind that if your lender orders the appraisal, you likely won't receive a copy. Demand to see a copy of the appraisal, because chances are you will pay the fee for it.

What is an appraisal?

An appraisal is an evaluation of a home's value, so you'll know that what the buyer is asking is a fair and reasonable price. When you pay a professional for an appraisal of your house, you get an unbiased, informed assessment. The appraiser looks at the property and makes an assessment based on the home's size, features, amenities, condition, and recent sales of comparable homes in the neighbourhood. Remember, it's not just the home itself that determines its value, but what's around it as well. Things like noisy train tracks or a garbage dump near a home, even a great home, can change the value.

Appraisal reports must contain the purpose of the appraisal, the legal description or identification of the property examined, a listing of encumbrances (any financial charges owing against the property), and an analysis of the best use of the property.

The most common method of appraisal is the CMA, which is short for comparative market analysis (although sometimes it stands for competitive market analysis or current market analysis). To determine a property's value through a CMA, the appraiser compares the home you're considering buying to other homes in the same neighbourhood that are comparable in size, features, and amenities.

What will the appraiser look for?

The appraiser scours the house and the neighbourhood. In particular, appraisers look at the following:

- **Size, age, and condition of the house:** Does the home need repairs now or in the near future? Have upgrades, refinishing, or renovation work been put into the home recently? (This part of the appraisal tends to focus on kitchens and bathrooms.)
- **Operating systems:** Do the heating, air conditioning, plumbing, and electrical systems all function properly?
- **Amenities:** What luxury features does the home possess, such as a pool, wine cellar, hot tub, solarium, or four-car garage?
- **Neighbourhood characteristics and immediate surroundings:** What does the yard back onto? Which way do the windows face? Are schools, shopping, and transit services nearby? Is the home within what's considered a safe neighbourhood?
- **Special or unique features of the home:** Is it a designated heritage home, or is it situated on a ravine lot with a stunning view?

Appraisers are required to do only a visual inspection, but they may probe further. This means the appraisal process can vary in length, from a quick walk-through to an hours-long inspection. If you're requesting a very small mortgage, or have great assets and collateral securing your mortgage, the appraiser may even do a drive-by appraisal, a quick confirmation that the home is still standing and appears to be of fair value.

If you're looking at buying a condo, be warned that an appraiser may not be aware of the status of the condominium corporation and so may not take this into account. If you get to meet the appraiser, make sure you ask her if this has been factored into the assessment. If the appraisal is being ordered through your lending institution, make sure the lender is aware of any factors that may not be readily evident, and make sure the bank notifies the appraiser of these pertinent details that could affect the appraised value of the property. Maybe the current owners are asking $50,000 less than the appraised/fair market value because they want to unload their leaky condo before a huge repair bill comes in. Make sure the appraiser has as much information as possible (everything you know, she should know!) to determine market value.

What should I look for in an appraiser?

Certification is what you look for in an appraiser, plain and simple. An independent appraiser should have an AACI (Accredited Appraiser Canadian Institute) or CRA (Canadian Residential Appraiser) designation. Make sure you ask to see your appraiser's credentials.

Reputation is also key — work with someone you can trust. Ask any friends who've bought homes recently for their suggestions, or contact the Appraisal Institute of Canada (www.aicanada.ca) for a list of certified independent appraisers in your area.

How much should I expect to pay?

You can expect to pay anywhere from $200 to $500 for an appraiser's services. You may be able to work out an agreement with your mortgage lender to pick up the appraisal cost. Ask your agent about writing into your offer to purchase that it is (1) subject to financing, but also (2) subject to the buyer (you) receiving a satisfactory appraisal and perhaps even an inspection by an engineer if needed. (See Chapter 3 details on adding conditions to your offer.) This will help you make sure your house "appraises out" — you don't want to carry a mortgage on what you thought was a $500,000 home when it's appraised at only $400,000.

Your lawyer

You will definitely need a lawyer or notary to close the transaction — that is, to handle the final mortgage paperwork and title transfer. The best way to protect yourself and your rights is to show all contractual documents to your legal professional before signing them — or make any offer subject to having your lawyer or notary review all paperwork.

Besides needing a lawyer to check all the niggling little legal bits near closing time, you may find a lawyer can be indispensable early on in the deal as well. He or she is there to protect your rights and to make sure every part of the contract is a-okay. In the following sections, we explain what a lawyer does during two crucial times in the home-buying experience.

B.C. (Before closing)

The contract of purchase and sale (sometimes called the agreement of purchase and sale) is the legal document you and your agent use to make an offer to purchase a home, and you need to be sure it's done correctly. If your real estate agent has many years of experience drawing up home purchase offers, you may feel confident that she can write an offer and present it to the sellers without a lawyer's scrutiny. Don't take chances. If you have any concerns, ask your agent to add a subject clause to the offer that gives your lawyer a chance to review the agreement of purchase and sale after the sellers have accepted your offer, but before all the conditions of sale (the "subject to" clauses) are removed. You will likely have to stipulate a short 24- or 48-hour time period for the legal review or the seller may object to this condition.

The agreement of purchase and sale is a legally binding contract. A lawyer may be able to give you valuable input before you sign your agreement or before you remove your conditions and commit to buying the house. Damage control is often less effective and more costly and time-consuming than prevention. Yes, everyone makes mistakes. But if it's your lawyer's mistake, at least your lawyer is insured, which in turn protects you.

If you're buying a newly built home, you'll use your builder's agreement of purchase and sale, and it will be quite different from the standard form found in your province or region. No two builders' contracts are alike; they tend to be lengthy documents and often contain details that favour the builder. Have your lawyer or notary or agent advise you which clauses to remove before you sign, and which to clarify with the builder/seller.

A.D. (After the deal)

After you have signed the offer, your lawyer or notary handles the final mortgage and closing paperwork. Your lawyer furnishes the following important services:

- **Title search:** Checks that the sellers of the home are the registered owners of the property; checks that any claims registered against the property (any debts or liens, for example) are cleared before the title is transferred to you
- **Conveyancing:** Prepares and reviews all documents needed to transfer the ownership of the new home and ensures you get valid title (the deed) to the property
- **Application of title insurance:** If necessary, gets insurance that protects you and the lender in the event of any problems with the title or zoning of the property
- **Survey review:** Confirms the survey is accurate and valid and investigates any encroachments or rights of way on the subject property
- **Assessment of builder commitments:** Ensures the builder provides everything you're entitled to receive and that your new house has a valid occupancy permit from the local city or municipality
- **Tax investigation:** Checks whether any municipal taxes are owing, if you're buying a resale home, or determines whether you or your builder are responsible for paying GST, if you're buying a newly built home
- **Land transfer tax:** Calculates the amount of land transfer tax you must pay (if applicable in your province)
- **Fees payable to seller:** Tallies the adjustments (the amounts you owe the seller to compensate for prepaid utility bills, property taxes, rental income, if any, and other service fees paid in advance)

- **Mortgage paperwork:** Draws up your mortgage documentation (if the bank allows your lawyer to do this, which is usually the case — in some rare cases the bank will want their lawyer to draft the mortgage documents)
- **Strata obligations:** Examines current status of obligations in condominium or cooperative ownership arrangements

Looking for a lawyer or notary

The corporate lawyer you went to public school with in grade 3 is probably not the best legal counsel to use when you're buying a home. Look for someone who specializes in real estate law. In most of Canada this will be a lawyer; in Quebec, you will hire a notary. Friends, neighbours, or relatives who have recently bought or sold a home are a good source of recommendations. Your real estate agent, broker, or lender will also have contacts among local lawyers or notaries and should be able to give you the names of several real estate specialists to choose from. You can also find legal associations on the Internet.

Find someone who speaks your language. As you interview lawyers and notaries, pay attention to how open they are to your questions and how clear their answers are. If they make their fee structures sound complicated, they may not be able to adequately explain the ins and outs of your agreement of purchase and sale or other legal documents involved in the purchase of your home. Choose a lawyer you can understand and who has the patience to explain terms adequately.

Don't base your final choice of lawyer or notary only on price. More experienced lawyers will often charge higher rates but get more done in less time, saving you money in the long run. Also, keep in mind that you're hiring a lawyer to give you peace of mind. A competent lawyer or notary should be able to explain every step of the transaction to you in clear and simple language regardless of whether the firm occupies a flashy corporate office tower or a modest street-level suite.

Before you hire a real estate lawyer, make sure you know a bit about what you're getting into. Consider the following sections as guidelines for the questions you ask.

Local real estate experience

Tenancy laws, title registration procedures, and local property regulations such as zoning can all change periodically. A local real estate lawyer or notary will be up to date on all regional laws and will probably have good connections with the enforcing bodies. Two questions are key: How many years have you specialized in real estate law? How long have you worked in this region or city?

Fees and disbursements

We're sure you already know that a lawyer's fees can be positively heartstopping. Because you can't skip the cost of a lawyer (though your heart's probably skipped several beats by now!), you'd better know how much you should budget to cover legal expenses. Start by making these inquiries — and write down the answers:

- How do you structure your fees?
- Do you provide free estimates of cost?
- If I opt for a flat fee, what services are included?
- Under what foreseeable circumstances might I require additional services?
- When and how will you let me know if the fees go above the amount estimated?
- How much would you recommend I budget for disbursements?
- What taxes are applicable to the fees?

When you're searching for a lawyer, ask the ones you interview for references. Take the names and telephone numbers of some recent clients (if possible). If you found lawyers' or notaries' names using the phone book or a professional association, asking for references is especially important. Call the lawyer's references and see what they have to say.

Reference checks

For those of you who feel nervous about speaking to complete strangers as you're checking references, keep this list handy. Try asking a lawyer's former clients the following:

- Were you satisfied with your lawyer's services?
- Did you find any surprises in the final bill for your lawyer's services and disbursements?
- Did you feel your lawyer adequately explained to you the implications of all the decisions you made and the documents you signed?
- Is there anything else about this professional or the services provided that I should know?

Knowing What You Want in a Home

So many elements make up a home that often it's hard to decide which ones are most important to us. You may take many things for granted when you

have them (like huge closets!), but don't forget to make a record of those (sometimes) small items that make all the difference in your satisfaction with where you live. Remember to think seasonally, too. It's hard to remember in July that you need enough backyard space for a homemade ice rink, but come December when your 4-year-old daughter needs to practise her speed skating six times a day, what are you going to do?

Part of knowing what you want is knowing what you don't want. "I don't want to mow grass" is a good start, for example. Or, "I don't want a basement where my shoulders hit the ceiling." People generally don't like certain things about our current homes and other people's homes, whether it's the lack of water pressure, the windows not opening wide enough, or the lack of street parking. By identifying your pet peeves, you can zero in on what you're looking for.

Being pragmatic about your wishes

We all know what we'd like in our ideal home. The features of your dream home provide a good starting point for your search; most of us judge potential homes with our standards of perfection in mind.

Try to keep your mind focused on your home-buying needs. Don't let your emotions overrule practicalities. Even though you really want the house with the incredibly landscaped backyard, reminding yourself that the rest of the house just doesn't meet your basic needs will help you overlook the cosmetics.

If you're a first-time buyer, remember you are doing just that — buying for the first time. Chances are, you'll sell your home in five to ten years and trade up to a bigger one. So don't worry if you can't buy your absolute dream house in the perfect neighbourhood right now. Instead of trying to buy a house with seven bedrooms for the 12 kids you plan to raise, realize you can live comfortably right now with a four-bedroom house with a fenced-in backyard at a reasonable price. You may not like the idea of buying a smaller "starter home," but it puts you in a better position to buy a bigger home down the road without sacrificing vacations, evenings out, and hockey lessons to your mortgage. What you can afford will probably never match your ideal, but with a little bit of flexibility you can find a home that suits you until child number eight comes along.

Making the list

Because you're probably going to be making compromises, keep focused on your basic needs, and don't give them up too quickly, but know where you can compromise. Here are some of the things you need to consider:

- **Location:** Perhaps the most obvious factor . . . where do you want to live? After you have been pre-approved for a mortgage, you'll have a good idea what you can afford, which may determine where you will end up living. But within your price range, you will have a lot of options based on the type of home you are looking for.
- **Type of home:** What type of home would best suit your needs? If you have a habit of falling down the stairs and breaking your toes, you might think about buying a bungalow or an apartment-style condo. Or, perhaps you were thinking about a detached house, what with the "talented" family of violinists and all. If your tastes run to modern architecture, you won't want to look at century-old Victorian-style houses.
- **Exterior:** What do you need outside? Is there enough room for the Great Dane to do laps? Do you need fencing around your yard to keep the kids in? Do you need a sunny yard to garden in, or are you more of a herbicidal maniac? Like to throw summer parties? Then you'll probably want that sunny yard bricked in or covered with a large deck. Or maybe you need a lot of pavement on which to park your three cars, two motorcycles, and RV.
- **Kitchen:** What do you need in a kitchen? If you have a big family, you probably want an eat-in area and an automatic dishwasher. If you're a professional cook, counter space and large appliances may be your priority. The presence of appliances may not be the deciding factor, but room to install them is.
- **Bathrooms:** How many do you need? If you're looking for anything with more than one storey, bathroom location is important, too. Is there one on the ground floor, or do you have to send your guests up to the one between your kids' rooms? If you like to take long, relaxing bubble baths on Sundays, you won't be interested in a home with only stand-up showers.
- **Bedrooms:** How many bedrooms are you looking for? Do you need an extra one for a home office or frequent house guests? If you're just starting out and you may be having children in the not-so-distant future, count them in when calculating your needs. If your children are finally off to college and moving out, you may want fewer bedrooms.
- **Other considerations:** How small is too small for your bedroom? For your kitchen? Will stairs be a problem for anyone in your household, now or in the future? Do you need a finished basement for your home office, your home theatre, or your kids' playroom?

Use Table 2-1 to organize the features you need or want in a new home. Complete the chart by considering what is absolutely essential to your needs

and what you would really like to have (but could live without). For some items in the chart, like a dishwasher or a fireplace, it's a simple yes/no proposition. A fireplace might be "nice to have," but is it really essential? You decide.

Choosing features in a home isn't all sunshine and roses. You may think you want a corner lot with a big yard, but have you bargained for the snow shovelling, leaf raking, and lawn mowing that go with it? How about the settling foundation and structural decay of your dream Victorian mansion? We're not saying you should change your mind about what you want, but when you set your priorities, think about the drawbacks of maintenance and repair that go along with the benefits of home owning.

Table 2-1 Home Priority List

Feature	*Essential Need*	*Nice to Have*
Type of Home		
Detached, semi, and so on		
Victorian, modern, and so on		
Number of storeys		
Interior		
Size (m^2 or ft^2)		
Number of rooms		
Living Room		
Size (m^2 or ft^2)		
Open concept/separate dining room		
Fireplace		
Flooring		
Ceiling height		
Kitchen		
Size (m^2 or ft^2)		
Condition		

(continued)

Table 2-1 ***(continued)***

Feature	*Essential Need*	*Nice to Have*
Eat-in area		
Fridge		
Stove (gas?)		
Dishwasher		
Cupboards		
Countertops		
Flooring		
Bedrooms		
Number		
Walkout to balcony		
Closet space		
Flooring		
Master Bedroom		
Size (m^2 or ft^2)		
Ensuite bathroom		
Special features (walk-in closet, fireplace, and so on)		
Flooring		
Bathroom(s)		
Number		
Size (m^2 or ft^2)		
Location(s)		
Shower/tub/Jacuzzi		
Flooring		
Sunroom/Den/Home Office		
Size (m^2 or ft^2)		
Location		
Flooring		

Feature	*Essential Need*	*Nice to Have*
Family Room		
Size (m^2 or ft^2)		
Location		
Flooring		
Hallways		
Width (m or ft)		
Closets		
Flooring		
Basement		
Size (m^2 or ft^2)		
Finished		
In-law apartment		
Washer/dryer		
Heating (oil, water, and so on)		
Flooring		
Other		
Air conditioning		
Central vacuum		
Finished attic		
Property will accommodate extension		
View		
Security system		
New windows		
Natural light		
Exterior		
Frontage (size and direction facing)		
Brick/siding/wood		
Roofing material (slate, cedar shake, asphalt shingles)		

(continued)

Table 2-1 ***(continued)***

Feature	*Essential Need*	*Nice to Have*
Parking		
Garage		
Carport		
Space		
Private/shared driveway		
Street parking		
Yard		
Size (m^2 or ft^2)		
Shed		
Deck/patio/porches		
Fence enclosure		
Swimming pool		
Established landscaping		
Landscaping/garden space		
Sunlight		

Home Shopping Online

The Internet is a great place to start looking for a home in the hypothetical world, before you're quite ready to tackle the home tours and real estate agent relations in real life. Browsing home listings on the Web gives you an idea of what's available in the region you're looking at and the price range you can expect to pay. Plus, it lets you stay on top of new homes as they're listed, without trawling the neighbourhood for signs on the lawn.

Smart start: The MLS listings

The Multiple Listing Service (MLS) Web site, `www.mls.ca`, is a great place to start your home hunt. Brought to you by the Canadian Real Estate Association,

the MLS site lets you search for homes across Canada by linking you to local real estate board Web sites.

How does it work? Easy. From the MLS homepage you can choose the province you're looking for, and after that you can drill down to the region, city, or town. From there, you're led to a screen that asks you to specify the type of property you're interested in. Haven't decided between a condo and a townhouse? Not a problem — you can select more than one at the same time. You can then specify a price range and number of bedrooms and bathrooms. Want a home with a fireplace, a pool, or air conditioning? You can specify these kinds of special features too. (Sorry, "secret underground passage" is not an option.)

When you're into your MLS hunt, don't think you'll remember a certain home or listing; you'll forget it after you've gone through 20 more listings and your eyes have glazed over. Each home listed in MLS has its own MLS number, which is the locator used by real estate agents and Internet surfers like yourself to find the home. Think of it as the home's barcode. Take this number down on a piece of paper, along with a little info to help you remember it, like "Brick two-bedroom $175,000." If you want to find it again easily, return to the MLS homepage, where you can simply type in the number and be directed to the listing.

If you don't feel like being swamped with little bits of paper and sticky notes, use the "e-mail this listing to a friend" feature provided on most listings pages. You can simply e-mail yourself a copy of the listing (which will include all the pertinent facts, of course) and later you can check your e-mail inbox and review all the listings that caught your eye.

If you've painstakingly chosen all your search criteria for a two-bedroom duplex with fireplace in Sackville, New Brunswick, and then remember you're late picking up your kids from school, you don't have to start all over again when you get back. At the bottom of the search page, there's a box called Saved Searches. Just give your search a name like Sackville 1 and click the Save button. MLS will save the search for 30 days, and all you have to do is go to the Load Saved Search section at the top and select the one you want.

After you set your preferences, MLS shows you those properties that match your needs. You'll see a brief description of each home, a price, a photo if one is available, and the name and contact information of the real estate agent. Click the listing, and you may be led to the full MLS listing for the home or to the listing agent's Web site, which will include such details as lot size and dimensions of rooms, as well as additional photos, if they're available. The information in the MLS listings is standardized and extremely thorough; data on each home are listed on a form with most of the vital stats you'll need. Look at a sample listing resembling those of MLS later in this chapter. Even with the most detailed of listings, you might still have a few questions, but you're not

quite ready to arrange for a walk-through. That's okay. MLS lets you e-mail the agent who represents the home, so you can get those little questions out of the way before you pursue something seriously.

Does your dream home simply *have* to be at the base of Mount Snowytop or on the shores of scenic Lake Blackfly? No need to search through a pile of listings in the general area that may not meet your needs. Click the MLS Web site's Search by Community Keyword button, which lets you search listings by community, geographical landmark, or attraction.

The independents: eBay and private sellers

One of your first stops for privately listed homes on the Web is eBay's Canadian site, `www.ebay.ca`. You may have been here before under different pretences — eBay is the pre-eminent online auction site, where you can bid for just about anything you can pay money for, from antique paperweights to cars and, yes, even real estate. There's no stuffy auctioneer heading up this marketplace — auctions happen directly between the bidder(s) and the seller, with eBay acting as a virtual "auctioneer."

But here's the thing about real estate on eBay that's a little different from those 1960s Surfer Barbie and Ken dolls or the books of old stamps: You don't actually bid on or purchase real estate on eBay. That's right — the prices are indications of the seller's asking price, and the listings, rather than being actual auctions, are more like advertisements, where the seller gets to list the home with some details and contact information and you can follow up via e-mail, phone, and the like. So, unlike acquiring that $1.99 DVD of *Blazing Saddles,* you can't log on to eBay and end up with a home purchase 20 minutes later.

eBay's real estate offerings are divided into categories, such as "land" or "timeshares for sale." So far, these private listings aren't nearly as numerous as what you would find through MLS, but you may be able to find a diamond in the rough with repeated visits. But how do you know who this seller is, anyway, aside from the ever-so-helpful "Joe Shmoe Homes, Inc." seller name? eBay regulates all of its members through a feedback system, where members can leave positive or negative comments on both buyers and sellers. With one click you can access that feedback record, and quickly get a very good sense of whether this person's above board.

Even if you're looking at Canadian properties, on eBay.ca some of the prices you see might be in U.S. currency — which makes a significant difference in the selling price. Look for the "C" or "US" preceding the asking price.

The wide world of eBay need not be your only stop when looking for plum private sales. Try `www.craigslist.org`, a Web site chock full of classified

ads for everything from jobs to pets to real estate. In the past few years, the site's popularity has exploded. Each month, more than 15 million people peruse the listings and 8 million new postings are added. Although it's largely American, lots of listings are for real estate in and around major Canadian cities. It also has listings of properties for sale in countries outside of Canada and the United States. Just type the URL into the location bar and select which city you want. Then click on the type of classified ad you'd like to view, which in your case is "real estate for sale."

Postings are pretty varied in how much detail the seller provides. At the most basic level, you'll find the type of home, the asking price, its general location, and a contact e-mail address for the seller. Others include a few photos and a couple of paragraphs describing the size of various rooms, any recent renovations, and special features. Real estate agents can also advertise on Craigslist, so you may find a property you'd already dismissed on `www.mls.ca` also advertised on there — with the number of Web sites available to real estate agents, you'll need to sift through some duplication to find your dream home.

The city categories on Craigslist aren't always followed strictly, so to get the most out of your search, don't just look at the ads in one area. If you're interested in homes in Calgary, check the Edmonton listings too. If you're looking to move to PEI, search under Halifax.

You can also find a number of smaller, classified-ad-type Web sites that list homes on the Web. Most of these are regional by province, and can best be found by typing something like "Quebec private sale homes" into your favourite search engine. Some, such as Quebec's TATV (`www.ta.tv`), list a combination of real estate agent–represented and private sales.

Home Shopping Offline

If you already have a list of priorities that clearly outlines the features you need and want in a home, and you've done some neighbourhood research, you probably have a good idea what and where you want to buy. Now you can focus your attention on the real estate market.

Using your agent

Be open to the expert guidance your real estate agent has to offer. If you hired an agent, let that person match you with a new home. Agents spend hours every day looking at homes, and they have years of real estate experience.

A good agent who's in touch with the market may even know about sale properties before they're officially put on the market. (Refer to "Selecting Your Home-Buying Team" for advice on finding an agent.)

Give your agent as much information as you can about what you're looking for, but be open to his advice. If you feel your agent's not listening to you or not providing you with good service, talk about the situation. If you're not able to clear up the problem, you may need to find a different agent.

If you only want to live on one particular block, or in one specific apartment building, you can ask your agent to send out letters to people living there to see if they're considering moving. You may be able to find a property before it hits the market.

Watching the neighbourhood

Frequent the neighbourhoods you're interested in. Look for new For Sale signs and jot down the address, listing agent's name and phone number, or private seller's number. Talk to your agent about booking a time to see the home, or make your own appointment if you don't have an agent. Spending some time in the area gives you a better impression of the number of homes for sale, and your chances of finding a home there. If there appears to be little turnover, you may have to search in a different location. Make a note of any streets in the area you definitely do not want to live on (such as the street where backyards face the abandoned sugar refinery), so you and your agent don't waste time booking appointments to see homes there.

Monitoring MLS listings

The Multiple Listing Service (MLS) is a very useful home search tool. The MLS database contains listings of all homes for sale that are represented by a selling agent. A typical MLS listing gives you a great deal of detail about a given home, including the number and size of rooms, lot size, interior dimensions (square metres or square feet), approximate property taxes, and additional information — details such as "renovated kitchen" or "professionally landscaped." You can search MLS listings online at `www.mls.ca`; refer to "Home Shopping Online" for more information.

Figure 2-1 shows a sample home listing. Note that a listing contains many important details, which can save you, the buyer, wasted trips to see inappropriate homes. The distances to shopping and transit are given, as is information about plumbing, heating, and sewers.

OFFERED FOR SALE

1234 WATER STREET, TORONTO

Area:	Toronto	Price:	$848,000
Sub-area:	Forest Hill	Status:	Active
Lot Size:	50' x 120'	Title:	Freehold
Taxes:	$3,514 (2005)	Zoning:	RS1
Age:	66	Bedrooms:	6
Basement:	Finished	Bathrooms:	2 full / 2 half

Construction:	Frame — Wood	Possession:	T.B.A.
Foundation:	Concrete Perimeter	Clear Title:	Yes
Exterior:	Brick	Mortgage:	Treat as Clear Title
Roof:	Wood Shingle	Sewer:	Municipal
Fuel/Heating:	Forced Air/Natural Gas	Water Supply:	Municipal
No. of Fireplaces:	2	Fireplace:	GasNatural/Wood
Vendor Interest:	Freehold	Remodelling:	Completely

Amenities:	Air Conditioning, In-ground Sprinkler System, Garage Door Openers
Features Included:	Washer, Dryer, Fridge, Stove, Security System, Dishwasher
Site Influence:	Central Location, Recreation Nearby, Lane Access
Parking:	2 (double garage)

Total Floor Area Including Basement: 3,285 sq ft

Rooms:	(Main)	Living Room:	18.2' x 13'10	Dining Room:	13'4 x 10'
		Foyer:	10' x 6'	Kitchen:	11'10 x 10'6
		Family Room:	16' x 14'	Den:	11' x 12'
	(Up)	Master Bed:	12'8 x 10'4	Walk-in Closet:	4'2 x 3'8
		Bedroom:	9'5 x 9'5	Bedroom:	12' x 11'6
		Bedroom:	11' x 12'	Laundry:	14' x 12'
	(Bsmt)	Bsmt Bedroom:	11' x 11'	Bsmt Bedroom:	11'3 x 10' 10
		Bsmt Liv Room:	6'7 x 4'5	Bsmt Kitchen:	12' x 10'10

Comments: Beautiful character home with enchanting details including leaded glass windows and cross-hall living room/dining room, gleaming hardwood floors & double leaded glass French doors to dining room. Four bedrooms up, with good sized master bedroom with walk-in closet. Bright updated kitchen with eating area. Downstairs has a brand new two-bedroom suite with separate laundry. New plumbing, wiring, new sump moved to outside of house and drain tiles at front. A corner lot situated on a beautiful tree-lined street close to all amenities. All measurements are approximate and to be verified by buyer.

Listing Broker: Dummies Realty Inc. List date: October 16, 2005
Listing Agent: Tony Agent 416 123-1234 E-mail: tony@dummiesrealty.ca

Figure 2-1: A typical MLS listing.

Hearing the word (of mouth) on the street

The more people who know you're buying, the more people will suggest properties to you. Friends may have friends in the area who are thinking of selling. If you talk to people in the neighbourhood you're considering, you may get leads from strangers, too. Neighbours may know who's outgrowing

their home or who's retiring to Florida next winter. Don't underestimate the value of word-of-mouth networking.

Don't get so caught up in getting a bargain that you lose sight of what you're buying. If your cousin's neighbour's daughter-in-law's brother is trying to sell a home to you, make sure it's the house you want before you even think about shaking his hand. Don't forget you're trying to buy a home, not make a deal. Never ever engage in oral agreements even if the price seems right. You need a written agreement and the opportunity to do some in-depth investigation before you negotiate the price and terms of sale. An objective assessment of the property value and a professional home inspection must be carried out to ensure you make the right purchase decision. Use a lawyer!

Reading the news

Most cities have free weekly real estate magazines and newspapers that can usually be picked up at real estate offices, street boxes, and convenience stores. These weeklies contain a selection of local residential listings. However, they often promote various real estate agents as much as they promote the listings. In most cases, the real estate weeklies do not present all the homes on the market; they print just the listings of the companies that advertise within them. Some of the weeklies will also rotate ads so that a house will appear every second week. In some areas two or three real estate weeklies are published, and you would have to read them all to see everything on the market. Be aware that the printed listings are several days old by the time you see them, which may hurt your chances of buying any of the homes listed within the magazine or paper.

The classified sections of local newspapers also have real estate information worth examining — watch for open houses. Often the advertisements have keywords to clue you in on the property. "Reduced" or "motivated seller" may be good bargains. Terms like "TLC needed," "fixer-upper," or "handyman special" send strong cautionary signals.

Going to open houses

Often sellers have open houses when they first put their homes on the market, giving you a great opportunity to check them out. You can talk to the seller's agent in person. Find out why the sellers want to sell, and how motivated they are to sell. If you don't like the idea of having other people looking at the home at the same time as you, remember you can always make an appointment to see the home again privately. Pay attention to what other potential

buyers have to say; they may notice something about the home that you've missed, or have done some productive snooping where you were too shy to look. Listen to their potential plans for the home; they may give you some good ideas.

Don't misrepresent yourself to the seller's agent. If you're working with an agent of your own, be upfront about it when talking to the seller's agent at the open house. When an agent spends time and effort on your behalf and then finds out you're working with someone else, you can expect an angry reaction. Don't jeopardize your situation by being dishonest; you may face difficult sale negotiations if the seller's agent is unhappy with you.

In a hot real estate market, you'll find that many properties sell without ever hosting an open house. A home may be listed on MLS, and a few days later the selling agent may hold an open house to give other agents an opportunity to view the home, but a public open house just isn't necessary.

Chapter 3

Getting the Home You Want

In This Chapter

- Getting ready to make an offer
- Writing it all down — making your offer to purchase
- Setting out terms and conditions
- Going through your contract of purchase and sale
- Negotiating your way to the best deal
- Knowing who does what with inspections
- Understanding the importance of property surveys
- Claiming your rights under warranties

Your ideal gem of a home is finally here. Your goal is to successfully negotiate a deal to buy the wondrous abode. Look in this chapter for advice on making an offer to purchase a home and how to write the best possible terms into your sale contract. We explain what the conditions ("subject to" clauses) in your agreement mean — and why you want them, anyway.

Soon enough you can go back to loafing around watching TV, or tooling around on your bike, or driving your kids all over town, or whatever it is you used to fill your time with back before you decided to buy a new home (can you even remember anymore?). This chapter tells you what you need to know to make your purchase and get yourself the home you want.

The Contract of Purchase and Sale

Before you can call any home yours, you have to make an offer to purchase it from the sellers, and they must agree to accept your offer. The offer must be made in writing. Just saying, "Hey, I'll give you millions of dollars for your house" won't hold up in court (and if you have a habit of exaggerating, thank goodness for that!). The sellers won't take you seriously enough to consider your offer unless it's on paper. Your agent will have all the necessary paperwork required to make an offer. If you don't have an agent, your lawyer will be able to draft the contract for you. Known as a contract of purchase and

sale, or an agreement of purchase and sale in some provinces, it includes basic terms and phrases that protect both the buyer and the seller.

Slightly different forms are offered by the provincial real estate associations across Canada. Although your agent completes the entire contract form, the document is considered an "offer" to purchase a home only up until you and the seller come to full agreement on the contract's terms and conditions, and you both meet those conditions acceptably. In some cases, you and the seller will go back and forth several times before you decide on conditions and terms you can both live with. Because much of the contract's legalese can be daunting, in this section we describe the main parts of the contract in plain language. Also, your lawyer or agent will be more than happy to go through it with you and answer any questions you might have.

Go through any contract you sign very carefully. Determine your needs and wants for each item. Write them down if it helps. The common advice for every decision also applies here: Be realistic. If you don't want to go above your offer price, be flexible on other terms.

Who's who and what's what in your contract

The exact terminology and organization of contracts may vary from region to region, but five elements are basic to every contract of purchase and sale:

- **Seller:** The seller's full legal name, exactly as it is shown on the current title deed to the house, is written into the contract.
- **Buyer:** Write in your legal name, exactly as it is shown on your personal identification documents and exactly as it should be shown on the deed. If you and a partner are making a joint purchase, add both full names. Joint purchases can take two forms:
  - *Joint tenancy* allows for the "right of survivorship" from one spouse to the other when one dies.
  - *Tenancy in common* allows for one spouse's interest in the house to go to that spouse's heirs, not automatically to the other spouse.
- **Subject property:** Subject property refers to the street address and an exact legal description of the property you are buying. This may also include the lot size, a general description of the home (semi-detached, single family dwelling with a mutual drive, or other), the specific lot and plan number, and any easements. If an easement is mentioned here, it will be acknowledged in more detail in the body of the contract as well. An easement, or "right of way," is a specified area of a property that is acquired by another property owner for her benefit. For example, your neighbour's driveway may cross the corner of your property. Because

it's her driveway, even though it's technically on your property, she has the right to use that part of your property to park her car. This right is registered on your title, and will be acknowledged in the contract.

- **Purchase price:** The purchase price is the price you're initially willing to pay. This price will probably change throughout the negotiation; it may go up and down repeatedly. When setting your offer price, keep in mind the additional expenses you'll be incurring, such as a land transfer tax, realty taxes, fuel and water rates, legal fees, and insurance costs.

  Also allow yourself room to negotiate up. If it's a seller's market (more people looking to buy than homes for sale), you may want to make a higher initial offer right off.

- **Deposit:** Your deposit is not only part of your down payment, but also an indication to the seller of your interest in the house and a sign that you are negotiating in good faith. The initial deposit may be relatively low, but the total deposit may be much more. At least 5 to 10 percent of the purchase price is often considered a fair amount for a total deposit, but no hard and fast rules exist. Your real estate agent can advise you what is standard practice regarding deposits in your area.

List the amount of the deposit accompanying your offer and specify that it will be applied to the purchase price of the house on the closing (or completion) of the sale. Normally it will be held in trust by your agent in a trust account until the completion of the sale. In some provinces, the standard procedure is for the deposit to be held in the listing agent's trust account. You may want to write in that any interest accruing while the funds are in trust accrues to the buyer, and will be paid after completion of the sale.

Note that if you back out of an offer after it has been accepted and all the terms and conditions have been met (that is, the subjects have been removed), you will most likely have to ultimately forfeit your deposit to the vendor and will likely open yourself up to other expensive legal action and possible damages. If you want to try to get out of the deal, consult a lawyer and be prepared for bad news.

Reading all about terms and conditions ("subject to" clauses)

Most contracts have a blank space where you can write in the specific terms and conditions of your offer. This is where you build as much safety into your offer as you need. You can make your offer unconditional, meaning that you do not require the seller to do anything except agree to the purchase price, deposit, and other terms of the contract. However, we advise that you make your offer subject to some conditions — these will give you some protection from making a bad purchase.

Conditions are typically worded as "conditional upon" or "subject to" clauses (I will buy the house, subject to financing, conditional upon inspection, subject to selling my current house, or some other condition). Basically you are saying, in legal terms, I will buy your house if particular conditions are met, such as:

- **Subject to financing:** You will buy the home if you're able to arrange a suitable mortgage. (Note that some buyers specify the maximum interest rate, the payment schedule, and the monthly payment amount they can consider.)
- **Subject to selling my present home:** You will buy the seller's home if you can sell the home you currently own (within a set period of time, such as 30 to 60 days).
- **Subject to the home's repair:** You will purchase the home if the seller fixes the leaky roof or other substandard feature.
- **Subject to legal review:** You will purchase the home provided that your lawyer reviews and approves the contract (usually within a specified amount of time, such as 24 to 48 hours).
- **Subject to inspection:** You will buy the home if it passes a professional building inspection.
- **Subject to survey:** You will purchase the home if a land survey is conducted or a legal, up-to-date land survey is provided, showing that the home does not violate any easements or rights-of-way.
- **Subject to appraisal:** Although your financing is pre-approved, the home is in your price range, and you know you can get a mortgage, you may want to confirm that your offer is reasonable and at "fair market value." If you have any doubts, you can make the offer subject to your receiving and approving an appraisal of the subject property.

Specific requirements can also be written in the same area as your conditions, such as the stated requirement that the seller agrees to remove the abandoned car from the garage prior to the completion date. There may not be enough space on the contract to add all your terms and conditions. They can be written up on schedule forms, which are attached to the main body of the contract. Schedule forms (or addenda, or appendices in some provinces) are extra forms that allow you to write as many terms and conditions as are necessary on additional pages that form part of the contract. Make sure that all the schedules you attach are listed on the contract. Keep in mind that when you start negotiating you may end up adding or removing conditions, and so might the seller. For example, if the vendor will not fix the roof then you may agree to remove that condition but try to deduct the estimated cost of that repair from your offered price.

Don't overdo the conditions. Write a thorough, detailed offer, but make sure you keep your conditions from piling up. Be reasonable. Don't write into your offer that you have the right to inspect the property five times before the closing date — one or two times should suffice.

After you and the seller sign off on all the terms and conditions of your purchase offer, your conditions will (hopefully!) be met and you can then add the paperwork (addendums or waivers, if necessary) to confirm, for example, that the roof has been repaired, that you have secured a mortgage, that you have sold your current house, and so on. After all the conditions are removed, you enter into a binding agreement to purchase and — here's the best part — you've bought your new home.

Scheduling the deal

Timing of the sale — which includes scheduling the completion date, the possession date, and the adjustment date, defined below — is handled differently in different parts of Canada. Your agent will be able to tell you what to expect and help negotiate dates that will work for you.

As a basic guideline, be aware of the following important deadlines:

- **Irrevocability/time allowed for acceptance:** Irrevocability, or the time allowed for acceptance, is a deadline written into your terms and conditions — for example, 48 hours — for the seller to respond to the offer, or counteroffer. If you hear nothing after 48 hours, it means the seller has refused your offer. You can, however, make another offer after that point. You may also revoke your offer any time up until it is accepted.
- **Viewed date:** The viewed date, a specific date on which you viewed the house, confirms that the property and everything included in the sale will be in the same condition they were in when you toured the home and observed them on that particular date. The viewed date is written into the contract.
- **Completion date:** The completion date (also known as the closing date) is the date when the money (via certified cheque, bank draft, or lawyer's/notary's trust cheque) will be delivered. Note that the seller is entitled to his proceeds *on* the completion date. Therefore, all bank waiting periods should have been cleared in order to make the money readily available to the seller. To avoid difficulties, deposit the money or hand over a cheque at least two days before the completion date. Because of the legal transfer of funds, the completion date is also the date by which all documents need to be registered, signed, and acknowledged as legally binding.

- **Possession date:** The possession date is when the property is vacant for you to move in. You will not be able to move in to (take possession of) the property before the seller has received your payment. Usually, possession takes effect at noon on the date specified in the contract. Under some circumstances, however, you may take possession on the completion date.
- **Adjustment date:** On the adjustment date, you, the buyer, assume all tax rates, local improvement assessments, and utility charges related to your new property. Any bills that have been prepaid will be prorated and your portion will be charged to you. The adjustment date is usually the same as the possession date.

Many contracts of purchase and sale are signed without absolutely definite closing and possession dates in mind. Unless you're adamant that you must close on February 29 or on your astrologically chosen day, letting the sellers know you would like to close in approximately 30 or 60 days (or however many you're thinking) is recommended to give the sellers some flexibility. You and the sellers will probably agree on some arbitrary date to write into the contract — to change at a later date, if necessary. When your offer is accepted, though, it's a good idea to agree on a final set of dates early on, so you can start to finalize things with your lawyer, lender, and home insurance agent. Your real estate agent or lawyer can draw up an amendment or waiver to your contract to change the date if both parties agree to the change.

In some provinces, such as British Columbia, the closing date and the possession dates are usually two separate dates, allowing for the money the buyer gives to the seller to be processed before the buyer gets possession of the home. In other provinces, such as Ontario, possession and completion dates are usually the same, so that you have possession of the home as soon as you are legally responsible for it. Because you use a lawyer's trust cheque or a bank draft, the seller doesn't worry about the cheque bouncing. If your possession and completion dates are the same, you may find yourself waiting impatiently while your lawyer goes down to city hall or the Land Titles Office with the seller's lawyer to change the title to your name — you probably won't get the keys until mid-afternoon of the closing day. So don't hire your movers for 9 a.m. on the day of closing, because they'll just spend hours waiting around to get into your new home.

When not to close: Don't close on a Friday if possible, or at the end of the month. These are busy days at the Land Titles Office and you don't want a problem to hold up the closing until the following Monday.

Should it stay or should it go?

The following three parts of the contract let you and the seller agree on what items of the house will stay for you to enjoy, and what items leave with the seller's moving truck:

- **Chattels:** Chattels are items that are not structurally part of the house and can be removed, but you may want to include them in the sale. Commonly purchased chattels include major appliances, such as the fridge and stove, but you can also include those drapes the sellers said they'd leave, or the unique works of art that make the "Elvis room" so magical.
- **Fixtures:** Fixtures are things that are affixed to the house, such as light fixtures, overhead fans, and built-in bookcases. Unless otherwise noted, fixtures are included in the purchase price of the home. If there's a crystal chandelier in the dining room that makes your jaw drop, be prepared for the seller to stipulate that it be excluded from the sale. If you don't want to let the chandelier go, be prepared to raise your offer to make sure it becomes yours.
- **Rental items:** Rental items are things the sellers rented, like hot water heaters or propane tanks and security systems. They are not included in the house's purchase price unless you and the seller agree they are. The contract should note that the buyer will assume the lease and all lease obligations for the propane tanks or security system. If the seller has not provided copies of the rental or lease documents prior to your offer, make the offer subject to your receiving and approving the lease agreements as necessary.

Make sure the seller doesn't bash the head off that Elvis bust you love before you move in, or steal the most valuable crystal teardrops from the chandelier. When you're writing up your contract's conditions, include a phrase like, "The property and all included items will be in substantially the same condition as when viewed by the buyer at the date of inspection." If you have any concerns that the seller may remove a fixture, try to inspect the house again just before the completion date.

Signing it all away

The signatures of both parties — all sellers and all buyers — are usually required on each page of the contract. These signatures should be witnessed where necessary. In some provinces, it may be sufficient to initial some of the pages. Your agent or lawyer will tell you where to sign and where to initial. If any changes are made during the negotiations, the buyer and the seller must initial the change to show it has been accepted.

The sellers must indicate their country of residency in the contract, somewhere near their signature. If the sellers are residents of Canada, you have no problem. However, if the sellers are not Canadian residents, your lawyer will want to make arrangements to ensure the sellers have paid all taxes due (or, alternatively, that taxes due are withheld from the proceeds of the sale). Otherwise, the Canada Revenue Agency could come knocking on your door looking for taxes payable from the long-gone sellers. Make sure the "residency" box or line is completed on the contract.

The Ins and Outs of Inspections

We can't stress this enough: Make sure your offer is subject to an inspection. You may think everything looks hunky-dory, but get a professional inspection anyway. Every real estate agent and home inspector has stories of the unexpected results that come from a seemingly straightforward home inspection. We've even included a couple of stories here, to show you just how important it is. Some sellers have inspections done before they put their homes on the market (a pre-inspection), but as a buyer you should have your own professional home inspection done. Occasionally lenders require an inspection before approving a mortgage, so unless you're Mr. or Ms. Moneybuckets and have the cash in your back pocket, getting financing may require you to carry out a property inspection. The same goes for condominiums. In the Vancouver market, for example, a lender may request a copy of an inspection report if she's unsure about a particular building's soundness, before giving final approval for the mortgage.

Include a "subject to inspection" clause in your contract of purchase and sale to purchase any home. In effect, a "subject to inspection" clause acts as a safety mechanism: It releases a buyer from the obligation to purchase a home if an inspector finds major faults in the building.

After the seller accepts your offer, have the home inspected as soon as possible. If the inspector spots any problems, you'll want as much time as possible to resolve them and make decisions. Even if the home is sound, the inspector will be able to share a lot of good information about your new home with you and tip you off to anything you'll want to keep an eye on.

Your inspector will look at the structural elements of the home, including the basement, the roof, and the heating, plumbing, and electrical systems as well as elevators and underground parking in condos. He or she usually goes systematically through the home and gives you a full, written report when finished. A good inspector will also make recommendations on what should be improved (for example, install GFCI outlets and a vent in the bathroom, or add a handrail to the basement stairs).

If any problems are uncovered — and this can be anything from a leaky gutter to an entire leaky condo development — it's decision time. One option is to collapse (cancel) your offer, because the condition of a positive inspection was not met. Your other option is to write a new term into the contract (if the seller agrees) that will require the seller to fix the leaky basement and any other problem areas. You are now renegotiating the contract, and adding new terms requires consent from both the seller and the buyer. If the seller refuses to accept a new conditional clause or an added term, your next option is to propose a price reduction to cover the costs you will incur to fix the problem.

If you and the seller can't reach an agreement, you can collapse the offer and look for another home.

Keep in mind that the seller is under no obligation to renegotiate. In fact, she may have priced the home acknowledging there was work to be done, and in her mind she has already discounted the price to cover the repairs.

Inspection costs can vary greatly if you're buying a very large or unusual property. In most cases, however, you'll find inspectors charge a fee in the range of $300 to $750. No one set price applies, as some inspectors charge based on the complexity of the property, while others charge using a sliding scale based on the size of the property. A typical building inspection will take at least two or three hours. On completion, you should receive a full, written inspection report that's signed and dated by the inspector.

In the event you are buying a larger, custom-built house (lucky you!) or a multifamily property, you may want to have a more comprehensive inspection conducted to inspect and analyze complex systems within the house. In this case, you might want to pay extra for a comprehensive inspection that will produce a technical audit report. This type of inspection typically takes 20 hours or more to perform and includes disassembly and disruption of the home's systems and components. You will need to get the owner's permission before conducting a technical audit because the inspector will be dismantling key components of the owner's home. If you're interested in a technical audit, check to make sure your inspector is capable of performing this type of inspection, and get a price estimate before proceeding.

Choosing a good inspector

Find an inspector with a good reputation and membership in the Canadian Association of Home and Property Inspectors (CAHPI). CAHPI maintains minimum standards for home inspectors regarding education and professional conduct. If you know any people who have recently bought (or possibly sold) their home, ask if they had an inspection and if they were happy with the inspector. If not, you can try a number of resources. Ask your real estate agent, lawyer, notary, lender, friends, relatives, or people in the neighbourhood if they can recommend some good inspectors, or call your provincial or regional association of home inspectors.

Your local CAHPI office can provide the names of home inspectors in good standing who work in your neighbourhood. Check to see if the inspectors you call are members of an association of home inspectors, have an office you can visit (rather than only a cell phone number), and have a current business licence. You can also access CAHPI on the Web at `www.cahpi.ca`. The Web

site has a Find a Home Inspector section that provides links to the Web sites of CAHPI's provincial chapters.

In many provinces, home inspectors are not regulated, so in those provinces anyone can hang their shingle out and call themselves a home inspector. Some inspectors may band together and form their own association. If they are not members of CAHPI, make sure they have the background, experience, liability insurance, and continuing education that members of CAHPI have as a condition of membership.

Inspecting a newly built home

Even if you're buying a newly built home, have an inspection done before you accept the home. You can make this part of your "pre-completion" inspection, before the completion of the sale. Contracts for new construction usually have a provision for a pre-completion deficiency inspection of the property. You can write into your contract that a professional building inspector will accompany you when you are doing your deficiency inspection. Before you agree to the terms of the sale contract, talk to your agent or lawyer to ensure you are entitled to a deficiency inspection.

Unless you know enough about construction to recognize potential problems or faulty work, bring along a professional home inspector. After the visual inspection is completed, you will be asked to sign a certificate of completion (sometimes also referred to as a certificate of completion and possession), stating that everything you paid for is complete. You can have the certificate drawn up by your lawyer and a representative of the builder, although many new home warranty program–registered builders will already have professionally prepared documents for this purpose. Any apparent omissions or defects discovered during your inspection should be noted on the certificate of completion, because this certificate is registered at your local new home warranty program office. Filing the certificate is necessary for your warranty coverage to commence.

If you've purchased a newly built condominium as a pre-sale (the building and unit were still under construction when you bought it from the developer), be aware that developers don't accept offers subject to home inspection after the unit is finished, but you can bring your home inspector along on the deficiency walk-through. It's not an official home inspection, and by this time you've already committed to buying the suite, but this is your chance to get the inspector to check out the unit just before you move in so you'll be aware of any problems. Your province's new home warranty program (which we discuss later in this chapter) can protect you against any serious construction defects.

Your inspector should double-check that the materials the builders used are the same as what you requested or expected, that new appliances are properly installed, and that fittings and equipment are located as specified. Look at many of the same things you would investigate if you bought a resale home: Make sure the gradient, the angles of the land around the foundation, will direct water away from the house, and look for any signs of leaking in the basement and from the roof. Check the metal flashings around windows and the chimney to make sure they are properly caulked, and check to make sure all the toilets flush properly. (You wouldn't believe what gets thrown down the toilet during the construction process!)

Most home inspectors, especially if they're affiliated with CAHPI or their provincial home inspectors association, are honest and pride themselves on thorough work. If, however, you've had a home inspection and you feel dissatisfied with the results, it's your right to have a second inspection performed (like a second opinion at the doctor's). To go further, if you feel the inspector was incompetent, report him or her to the local professional association.

Anticipating the inspection

A professional inspector knows what to look for to ensure a resale home is up to snuff — that it meets modern requirements and has a sound structure. An average inspection should take at least two or three hours, depending on the size of the home. A good inspector will have you accompany him and will encourage lots of questions. Sometimes the inspector will start when you're not in the home — you won't have much to do when the inspector is poking through the attic. Definitely plan to be present for the last hour or two of the inspection so the inspector can go over the good, the bad, and the ugly with you.

An inspection is a visual walk-through to report on the elements of the home. It's not meant to be a picky this-doorknob-won't-turn-fully kind of examination, but an overall report of whether the home is sound. Of course, you don't get any guarantees, because a home may have problems even the inspector can't find. If the sewer system (which belongs to the city) under your new home is about to collapse, causing the bottom to literally fall out of your house, an inspector can't anticipate that.

The inspector completes most of the inspection report while touring the property, so the report is usually organized into locations starting with the site itself, and working through the exterior and interior of the house. Your inspection report should cover all categories of concern relevant to each part of the house and property, including structural, exterior, interior, plumbing, electrical, and heating and ventilation components. A rough list of the kinds of problems an inspection report will alert you to follows.

Home exterior

Your inspector will examine the following exterior components of the house:

- **Roof surface:** The roof should be in at least visibly good condition. An unacceptably aged roof surface will be obvious, but in the early stages roof degeneration can be quite subtle, and virtually invisible to the untrained eye. A roof surface in poor condition can mean water leakage or poor insulation, and in extreme cases can even lead to roof collapse.
- **Eaves:** The eaves should be in good condition, with no holes and minimal rust. Eaves in poor condition mean rain and snow will not drain appropriately, and this can cause serious difficulties if water accumulates on your roof or near your home's foundation.
- **Chimney(s):** The chimney(s) should be free from cracks or loose sections in the masonry, and should have a chimney cap. Chimneys in poor shape could cause ventilation problems.
- **Chimney flue(s):** The chimney flue is the exhaust vent over the fireplace. An unused fireplace can quickly have its flue blocked by debris or even a bird nest or two. Flues that are not in good condition may signal a malfunctioning or improperly maintained chimney.
- **Windows:** The windows should not show any signs of wood or water damage. Damaged windows will be sure indications of water and air penetration into the interior of the home.
- **Siding/exterior walls:** Whether brick or siding, the house's exterior walls should be free of cracks, gaps, or signs of water damage. These will be possible indications of damage to interior materials, rotting, or mould inside walls. Watch out!
- **Gradient:** The gradient, or slope of the ground, should be properly angled away from the home. An incorrect gradient will allow water drainage into the basement or foundation, causing water damage, rotting, or even fungus growth.
- **Foundation:** The house's foundation should be free of cracks, bulges, or deformities. These abnormalities could indicate an extremely serious structural problem. Also, termite tubes or other signs of infestation will manifest themselves in this area.
- **Septic system/cesspool:** Septic tanks and cesspools should be tested for possible leaching. You can request a dye test if the inspector does not plan to run one.

Basic home interior

On the inside, you can expect your inspector to check for:

- **Flooding/leaks:** The inspector will note these and other visible signs of water damage inside the house. The inspector will also be able to tell you if any waterproofing measures, a sump pump, or other additions

have been installed. A sump pump is an electric pump installed in a recess in the basement (or occasionally outside the house) that will kick into action if the level of water in the drainage system starts to rise. The pump will mechanically aid the gravitational flow of the water away from the house. Waterproofing a house is extremely expensive, making it important for buyers to be aware of measures already in place.

- **Insulation/ventilation:** If the house leaks or doesn't allow moisture to evaporate, pretty much all of the major structural components are put at risk. Excessive moisture can cause rotting, rust, electrical shorts, and fungal growth. Furthermore, good insulation and ventilation will keep heating and cooling costs to a minimum.
- **Other unsafe components:** This is largely dependent on the age of the house. For example, paint may be old enough to contain lead; there may be missing railings on staircases; or there could be urea formaldehyde foam insulation (UFFI) or asbestos-laced Zonolite insulation throughout the home. Building materials change over the years, and so do safety standards. A qualified inspector will have up-to-date information and will recognize potentially dangerous components.

Interior systems/mechanics

Your inspector examines these systems:

- **Plumbing:** Plumbing systems and pipes may no longer be up to snuff. The inspector will be on the lookout for rust and leaking or water stains that warrant further examination. Checking water pressure and the condition of drains and pipes is also part of the job.
- **Heating:** Heating systems may be outdated or inefficient. For example, the valve that controls the flow of hot water into radiators can rust away, leaving you with no way to turn down the heat in that individual unit. Other problems might be unsafe exhaust venting or blocked chimneys. The inspector looks for all of these problems, as well as for indications that the furnace, including the motor and burners, is functioning properly.
- **Electrical:** Electrical systems may be potential fire hazards or simply not dependable. Wiring always warrants extra attention. Your inspector should check any exposed wiring and its condition. If your house or condominium was built in the 1970s, it may have aluminum wiring that is not reliable. In aluminum wires, electricity actually flows away from the screws used to hold the wiring in place at the back of an electrical outlet. Air pockets form between the wires and the screws, letting electricity arc between them, ultimately burning the wire away and deadening the outlet. Your inspector checks for signs of unreliable wiring, and also for problems such as reverse polarity outlets and two-prong convenience outlets. Also, older knob and tube wiring or old 60-amp systems are very difficult to insure. Remember, these issues aren't just about saving money on expensive repairs; they're about your and your family's safety.

The home inspection is a chance to review the home before you commit to buy the property. In general, you need to have a "reasonable" reason not to proceed with your purchase. Because of this, in many provinces the property inspection clause will include a price for repairs that the buyer is prepared to accept before deciding not to proceed with the purchase. This prevents the buyer from walking away from a home because a lightbulb is burned out. It also means that if they change their mind and don't want to buy the property, they may not be able to use the "inspection clause" to get out of the purchase.

A typical inspection clause with a cost consideration would read:

> *This offer is subject to the buyer on or before [insert date], at the buyer's expense, receiving and approving an inspection report against any defects whose total cost of repair exceeds $—— [this amount can be negotiated, but it may be $500 or more] and which adversely affect the property's use or value. This condition is for the sole benefit of the buyer.*

A good inspector won't offer to do home repairs for you — it would be a huge conflict of interest. Your inspector should not recommend contractors to do the repairs unless they are very specialized repairs that require highly skilled trades. Your inspector is hired to investigate your home — not to give work to his buddies in the building trades.

Condominium inspections

If you're buying a condominium, you may think you don't need an inspection. Obviously the place is well maintained by the residents or management company, and if it's new, how can there be anything wrong with it, right? Actually, those aren't safe assumptions. Home inspections don't apply strictly to detached houses — condominiums should get inspected too! In fact, during a condo inspection, many of the issues similar to those of a house are checked out, and if you read on you'll see why an inspection of any unit you may wish to call home is valuable.

Outside the condo

The inspector will usually start with the outside of the building. He or she will check to make sure all exterior components are well designed, well maintained, and functioning properly. He or she will examine the caulking and sealing around the windows, doors, and building details to be sure they're in good shape. If the building has a brick facade, the inspector will check the brickwork for loose bricks and to see if the mortar is holding the bricks properly and not deteriorating and leaking. If the building has a stucco exterior, the inspector will check for hints of water ingress and staining, especially in

leaky-condo-prone British Columbia. The inspector will also walk through the parking garage and check for any leaks or water ingress into the underground parkade.

The inspector will check out the roof of the building to make sure the roof and drainage system are being well maintained and serviced. He or she may also check out any vents and skylights and make sure they were properly installed and are being maintained. If the building has a central boiler supplying hot water (as opposed to individual in-suite hot water tanks) the inspector will usually want to inspect the boiler room to make sure the system is up to date and working properly. As for balconies or patios, the inspector will also check to make sure they have adequate drains and that no water is pooling on them, which can lead to rot in balconies that have a membrane over a wood frame.

Inside the condo

Inside the suite, the inspector will check the wiring throughout. He or she will check the electrical panel and make sure the wiring is up to snuff, and check the electrical outlets to see that they are all grounded and working properly. The inspector will also check all plumbing fixtures and check the suite for leaks. Most inspectors will also check the appliances included in the sale, but some focus more on the structure of the building and the condition of the systems within the suite.

Before booking an inspection for a condominium, ask the inspector if he or she wants access to the roof, the boiler room, and any other common areas. These places are usually locked, so the property manager or a resident of the building may need to be there to give the inspector access.

You Are the Owner of All You Survey

Once upon a time, kings and queens built their castles on hills because they could rule over all they could see. In today's smaller kingdoms, you can rule over all you survey. Surprisingly, many of Canada's home buyers don't bother to get an updated land survey before closing the deal — especially when you consider that your lender will probably want to see a copy before agreeing to finance the purchase, and your lawyer will draw up your deed using information from the survey. The sellers may have a survey of the property and the bank may accept a recent survey, but if any uncertainty exists, a new survey will be required. No surveys are required for condominiums.

Land surveys are also known as building location certificates, mortgage certificates, surveyor's certificates, real property reports, plot plans, and certificates of non-encroachment.

Understanding why you need a survey

A land survey is a legal map of a property's boundaries. In the best-case scenario, the seller will have provided you with an up-to-date survey that's perfectly legal — in other words, one that's copyrighted and valid only if the original is signed and sealed. If the survey the seller hands you is old, unsealed, or otherwise fishy in any way, get your own done. When it's performed by a professional who is familiar with your region, a land survey

- Gives you certified, accurate measurements of the property and the exact location of the house, garden shed, garage, and any other buildings on it.
- Lets you know of environmental or contamination problems on your site, such as whether your well draws on runoff from a nearby major road, or whether the site is in an area proven to contain dangerous levels of lead in the soil.
- States who may review the survey. A land survey, contrary to popular belief, is not a public document.

If no up-to-date survey is available, be sure to write "subject to survey" into your offer — this will allow enough time for a proper and thorough survey to be done. A slipshod, cheap, hurried survey won't do you any good if a boundary dispute comes up, or if you decide to subdivide, build an addition, or re-mortgage.

Finding a professional surveyor

Like finding a good doctor or mechanic, the first step in the hunt for a professional surveyor is to ask around. Ask the previous owners of the home for the company they used — or if your lender has requested a survey, they will often recommend one. They may provide you with an excellent surveyor who is familiar with your locality — and all the environmental, archaeological, and regulatory quirks that might go along with it. Your agent, lender, banker, or lawyer may also be able to recommend a surveyor.

Failing this approach, hit the Yellow Pages or Canada411.ca. You may also be able to navigate the Net for a good surveyor. Many provincial land surveyors' associations have Web sites, complete with member lists and other helpful information. Look for long-established companies, or those that are members of your provincial land surveyors association. Call three of them, describing the job you need done, and be ready to supply them with a legal description of the property as well as the civic address. Record how each company proposes to do the job and approximately how much they would charge to do it.

Finally, ask to see samples of their work. Compare the companies' methods, estimates, and samples, and you'll find the surveyor who is right for you.

Does This Come with a Warranty?

A $30 clock radio comes with a warranty, but what about your home? If you're buying a newly built home, you may be covered by something called a new home warranty. But it's nothing like the piece of paper that came with your new coffeemaker. A new home warranty is actually a type of third-party insurance. And it may or may not come with your home, depending on whether or not your builder has bought into a plan.

Complicated? Well, yes. Basically, a new home warranty is insurance for your builder while the home is being built. Then, when the certificate of completion has been transferred over to you, it becomes a kind of consumer warranty. Unlike homeowner's insurance, the builder, rather than the home buyer, buys the policy. Of course, just because you don't buy it doesn't mean you won't end up paying for it: The builder will likely tack the cost of the warranty on to the purchase price.

Legislation concerning new home warranties varies across the country, and not all provinces require them. In other words, not all homes come with them, and not all homes are covered in the same way. You'll have to ask your builder whether your home is protected by one. Your builder should be able to provide you with a registration, enrolment, or membership number for the warranty plan. That way, you can check with the issuer of the warranty to ensure everything is in order.

If you do have a warranty for your home, keep it. Keep all documentation and policy information, registration confirmation, and contact numbers somewhere safe, where you can access them if you ever need to.

Note that in order to be covered under a province's new home warranty program (NHWP), you may have to pay a registration fee, although generally the builder pays all associated fees. Pay attention to the timing and schedule of the warranty. Some coverage is good for only one year after you take possession of the house, and coverage of different problems may expire at different times. If you do have any problems or questions, call your provincial NHWP office. They can answer your questions and give you a list of builders registered with them as members of the NHWP. Some provincial NHWP offices provide ratings of the local registered builders based on track record for both creating and solving problems. Others supply you with a list of criteria that builders have to meet in order to be registered members. Either way, you get the security of knowing you're choosing a builder that has been evaluated on

a regular basis and meets high standards for quality and service. The new home warranty program should be listed in your local phone book, or your provincial government's Consumer Affairs ministry can direct you to the warranty program specific to your province.

Knowing what's covered

So what does your new home warranty cover? The details vary across the country. Most include protection for some (but not necessarily all) of the following, with different items covered for different lengths of time:

- Settling cracks in drywall (usually for the first year or two)
- Defects in workmanship and materials
- Water penetration
- Violations of building and safety codes
- Structural defects
- Down payment protection

Timelines on the coverage also vary from sea to shining sea, so you'll have to check your specific policy for the details. You need to know what you're covered for as well as what you're *not* covered for.

Understanding warranties

A warranty can come in handy when things go wrong. If your "unobstructed view of the lake" is seen through a gaping hole in the wall, you'll want to have that certificate to turn to. In the best of worlds, you let your builder know of the problem and he builds you a new bay window where you can relax and enjoy the vista. In the worst of worlds, he might argue that the hole isn't really a hole, but a great alternative to a cat door. Without another person there to arbitrate — except for the courts — things can get ugly pretty quickly.

In the event that you and your builder disagree over needed repairs, or what exactly qualifies as a defect, a new home warranty can come in handy. Because a new home warranty is backed by a third party, someone else can step in to settle disputes, keeping both your interests and the builder's interests in mind.

You might want to think twice about your purchase if your builder isn't making a warranty part of the bargain. If you're buying a condo, make sure you get a warranty for the unit and that the condominium board has a separate warranty that covers the common elements.

Put it in writing

Verbal agreements don't usually hold much clout. If you notice any defects and wish to make a claim, you must put the complaint in writing to your builder and keep a copy for your records. Send a copy to the issuer of the warranty to keep on file in case of a dispute. Photographs are also a good way to document problems. Many builders will give you a form to fill out; otherwise, organize your concerns room by room and include as much detail as possible about the nature of the problem. These documents should always include the plan number, lot number, and address of the residence in question. Oh, and, of course, you have to file before the end of the warranty period.

When things go awry

Your warranty should outline a "reasonable time frame" in which builders should fix any problems that have been brought to their attention. "Reasonable," unfortunately, can mean a lot of things. One plan, for instance, gives builders up to a year to rectify defects. So if the light fixture in your bathroom doesn't work, you might be sitting in the dark for a long, long time. Getting your brother to rewire might not be a good idea: Most plans won't automatically reimburse you if you go ahead and get someone else to do the work, and some repairs might void the warranty altogether.

If you're considering buying a converted condominium, you might not qualify for the new home warranty program, because although the individual units are new, the outside of the building isn't. Check with your provincial NHWP to see if the unit you're considering qualifies, and always get the details of the developer's warranty in writing.

Chapter 4

Deciding to Sell

In This Chapter

- Identifying good reasons to stay put
- Identifying good reasons to sell
- Timing the sale
- Pricing your home to sell
- Investigating the costs associated with selling
- Investigating financing options for existing mortgage holders

Few decisions have a bigger impact on your life — at every level — than the decision to sell your home. In fact, moving is one of the three most stressful life events (after death and divorce). A major change is scary, but as our lives develop, change may be necessary and even welcome. How much change you're ready for is up to you. You may decide you don't really need to move — you just need to tear down some walls and finally renovate that bathroom.

In this chapter, we explain how to sort your priorities so you can be sure you really do want to sell your home and you know what you want to gain from the sale. Taking the time to consider how selling your home affects your life helps you avoid costly and unnecessary mistakes, and ensures you'll be satisfied with your choices. Thinking it through and deciding what you really need gives you incredible peace of mind.

Good Reasons to Stay Put

Examine your lists of likes, dislikes, needs, wants, and priorities (we provide guidelines for such a list in Chapter 2). Pay particular attention to the physical features you want or need in a home and your financial status and goals. Both of these considerations may be reasons for you to stay in your current home.

- **Renovating is a viable option.** If you're after more space, a new look, modernization, or greater efficiency, renovating your home might be the wisest course of action. If you live in a great neighbourhood, consider building an addition. Renovations may be a steal compared to the transaction costs of selling, and they may also add to the resale value of your home. See Chapter 6 for more details on which home renovation projects add the most value when you do decide to sell your home.

  If you want to move because your home needs some costly repairs, investigate your options carefully. You may end up paying for the repairs anyway when your home doesn't sell because of them, or when the buyers insist on deducting the repair cost from the price they will pay for the home. Buyers often overestimate the cost of repairs in order to protect themselves from the worst-case scenario.

- **Your finances are shaky.** If you're already having trouble living within your means, it may be wise to delay buying your dream home until you've paid off your credit cards and devised a realistic plan to reach your financial goals. Even if you're thinking about moving to a less expensive house, keep in mind you will incur plenty of one-time expenses when you sell your home, buy a new one, and move. This means you have to be looking for accommodations in a range several thousand dollars below what you initially thought you could afford. If you can possibly get your debts under control while staying in your current home, your financial and emotional state will be that much better off.

  Nothing is more stressful than trying to move when you're strapped for cash — except perhaps trying to move when you are strapped for cash *and* time.

Good Reasons to Sell

Even if you love your home, sometimes it just won't be able to adapt to your ever-changing needs. Because you can't always build what you need or make the neighbourhood exactly how and where you'd like it, it's often best to find a new place to call home. If any of the following conditions describe your situation, you're probably ready to sell.

- **The location of your home is unsuitable.** If you have a job offer in a great location with good long-term employment potential, or if you're ready to retire and look forward to the security and low maintenance of a retirement community, selling your home makes a lot of sense. (And if you're relocating for professional reasons, you may get a tax break on your moving expenses.)

- **Your house is too small or too big.** If you and your family need more space and you don't want to renovate, or you can't get a building permit to put an extension on the back of the house, moving is probably your best bet. On the flip side, if the last of your six kids has finally moved out of your seven-bedroom home, it may be time to downsize — before any of them decide to move back!
- **Life throws you a curveball.** After a traumatic event like a divorce or the death of a family member, you may simply want to leave bad memories behind. Take the time to review your financial situation and personal goals so you make a move that's right for you.
- **Life is fine — but the neighbourhood isn't.** Maybe your life hasn't changed a bit, but somehow the neighbourhood has changed around you in ways you're not happy about. If you find yourself with the best house on the street — or the worst — it's a good time to move. If every other bungalow in your formerly sleepy neighbourhood has been replaced by a monster house, the next time a real estate agent calls you, it's time to say, "Yes, as a matter of fact, I am interested in selling!"

Timing: Sell First and Then Buy, or Vice Versa?

Not a gambler? Even for people who enjoy moving from home to home, timing a move is really tricky. On the one hand, you could find yourself with no home, having sold your home and not found a new one of the appropriate size, style, or location. On the other hand, you could find yourself with no money as you carry two homes. You can avoid these pitfalls by basing your timing decisions on current real estate market trends and your own needs and priorities.

Riding the real estate cycle

Real estate goes through cycles. A seller's market occurs with a lot of buyers and not many homes available. This is also called a hot market, because homes tend to sell more quickly and for a higher price. In a hot market, you might nail down the home you want — the tough part in this case — and then sell your home.

A buyer's market, or a slow market, happens when more homes are listed for sale than buyers are shopping for new homes. Prices tend to be lower and

homes take longer to sell in a buyer's market. If the market is slow but you find a lot of homes you can see yourself happy in, sell your home first — the hard part in a slow market — and then pick your next home from among your favourites.

Although trying to sell your home in a buyer's market means you may have to drop your asking price, chances are the next home you buy will also be at a reduced price, because market conditions tend to be similar within a particular city or region. Unfortunately, if you're moving across the country, you can't count on being so lucky.

Real estate also goes through predictable highs and lows over the course of a year. Spring is usually a peak transaction time anywhere in the country. If you need to sell your home quickly during a slower time of the year, drop your price closer to actual market value or even a smidgen below actual market value. On the other hand, if you want to get the best price possible, put your home on the market at the beginning of the peak season. Market activity varies with geography, too, so talk to a local agent to find out what the trends are in your area. Price is an important marketing tool, so you want to get it right the first time. The section "Pricing Your Home to Sell" in this chapter gives you the lowdown on pricing do's and don'ts.

Meeting your needs

Your needs form another important variable in the buying and selling equation. Do you need to sell your home quickly? Do you need a certain price, and if so, are you willing to wait for it? Do you need to be in your next home by a particular date?

If you want to get your kids moved into a new home before the beginning of the school year, you may decide to buy that perfect home in the new area before you have sold your current home. The way to avoid hanging on to two homes is to price your current home to sell. For example, if you have to sell and are facing the prospect of owning two homes in six weeks' time (carrying both would probably cost you an extra $2,000 to $3,000 per month), drop your asking price by a couple thousand dollars. Accepting an offer — albeit below your original asking price — meets two important needs: Your kids start the new school year off on the right track and you have only one home to carry — much more manageable. Examine your financial situation and determine your personal priorities early. But, as a rule, it's almost always better to sell before you buy.

Anticipating how much you can get for your home

If you're going to sell your home, naturally you want to recoup the money you spent buying it and fixing it up, and you think about how much money

you need in order to buy your next home. Unfortunately, these factors don't determine the resale value of your home.

The cold, hard truth is that buyers determine the actual market value for your home through what they offer to pay for it. If all the similar homes in your neighbourhood sell in a certain price range, buyers will likely offer a similar price for your home. Surveying the asking prices and recent sale prices of comparable homes in your neighbourhood gives you a basic idea of what price you can expect to get. In effect, timing is everything — being aware of the real estate market's trends makes you better prepared to get the price you really want or need.

If you're working with a real estate agent or broker, ask for a comparative market analysis (CMA), a report used to determine a home's market value. Your home is "ranked" next to similar homes in your neighbourhood based on details like size, condition, desirable features, and listing and sale prices. If you're selling on your own, you would be wise to get a professional appraisal to determine the actual market value of your home.

Although it's not exactly a scientific approach, try talking to your neighbours to get an idea of what your home is worth. We're willing to bet that everyone on your street will also give you opinions on how much more your home could sell for with its renovated kitchen or the new hardwood floors.

Your home gets the most exposure to the buying market in its first few weeks of listing. The closer your home is priced to its actual market value, the more quickly it will sell. If you price your home too high and scare off buyers in the beginning, you may have to go through a few price reductions in order to sell. It makes more sense to price your house realistically from the get-go — you'll sell it months earlier.

Knowing what you can spend on your next home

Figuring out how much you can afford on your next home is a long but relatively simple equation. It involves solely the basic math of addition and subtraction. You need to total your cash inflow and outflow, then subtract the expenses from the income. The tricky part is taking inventory of all your sources of income and expenditures, and the exact amounts associated with each. Chapter 1 takes you through the cost assessments and calculations step by step.

Careful calculations help you be realistic about what you can afford. After you know how much you can spend, you need to investigate whether it really will get you the kind of house you want, while maintaining your standard of living and allowing you to save for long-term financial goals.

Never assume anything when investigating what you'll get for your money. The perfect home may not be in the perfect neighbourhood. The perfect neighbourhood may have listings in your price range only for properties half the size you need. You may have to make sacrifices to make improvements, so you need to know what your priorities are. Even if you can make a decent profit on the sale of your current home, no guarantee exists you'll be better off if you sell.

The safety net: Conditional subject-to-sale offers

One way to synchronize buying and selling is to find a home you like, make an offer conditional on the sale of your current home, and put your home on the market after the conditional offer is accepted. If the condition (selling your home) is not met by the expiry date in the clause, then the offer you made for the other home becomes null and void if you and the seller don't extend the subject-to-sale clause's time frame.

By writing a subject-to-sale condition into your purchase offer, you don't have to buy the home you want until you've sold the home you're living in — giving you the peace of mind and the financial security that comes with not owning two homes and not being homeless.

A subject-to-sale conditional offer is less attractive to a home seller and therefore puts the buyer in a weak negotiating position. Because most sellers don't want to delay the sale of their home, they often are willing to accept a "clean" offer for less money. If the seller receives such an offer and is considering it, they will usually invoke the time clause, the amount of time the first buyer has to either remove all the conditions from their offer — including the subject-to-sale condition — or withdraw their offer altogether. Now it's time to hustle. If you really want that home, you need to remove your subject-to-sale clause and firm up your offer, even though the competitive offer may be several thousand dollars less. Some sellers won't even look at offers made subject to the sale of the buyers' current house, as they don't believe the buyers are serious. Ask your real estate agent how conditional offers are received in your local market.

Here's how it works. You write into your offer a subject-to-sale clause that essentially states, "This offer is subject to the sale of the buyers' current residence located at [address], on or before [expiry date of clause]. However, if another acceptable offer is received, the sellers will notify the buyers in writing and give the buyers 48 hours [24 or 72 hours is also common] to remove

the subject-to-sale condition as well as all other conditions from the offer or the offer will be considered null and void." The expiry date of the clause indicates the amount of time you have to sell your house from the time the offer is accepted and therefore to remove the condition and make your offer firm, or withdraw your offer if the condition was not met. This date is usually negotiated to fall between four and six weeks after the offer is accepted and it can be extended if both parties agree.

Don't confuse the expiry date of the clause with the completion date of the offer itself. The completion date specifies the date you will close the deal if all the specified conditions are met. It is the day you become the legal owner of the property.

The time clause, which is negotiable, identifies how long you have to remove the subject-to-sale condition or withdraw your offer should the seller receive another acceptable offer before the expiry date on your clause. You see, even after the sellers accept your conditional purchase offer, they will still actively market their home, looking for a "clean offer" — an offer without conditions. If the seller receives another acceptable offer, they will invoke the time clause and notify you in writing that you have 24/48/72 hours (or whatever was written into the clause) to make a decision. At this point you can remove the conditions and commit to buying the home — whether or not you have sold your own — or you can withdraw the offer.

If you've really found your dream home and your conditional offer has been accepted, you don't want your subject-to-sale clause to expire or the time clause to be invoked before you sell your current property. You must price your home to sell, which means being very realistic about its market value. The closer your house is listed to market value, the more quickly you will receive good offers.

For most people, it makes sense to put your home on the market while you look for your next home. This gives you a good sense of what buyers are willing to pay for your home, and saves you from inflating the amount you think you can spend on your next home. If offers come rushing in, you can always accept the best, subject to the purchase of your next home.

Some buyers won't accept a seller's proposed counteroffer, especially if the counteroffer is conditional on the sellers' purchase of their next home. If you find yourself in this position, you have to decide what you're willing to risk. If you sell before you've found a new home, you risk becoming homeless — at least temporarily. On the other hand, if you reject the buyer's offer because you can't include the condition of buying your next home, you may wait a long time before receiving another one, depending on the market conditions and your pricing strategy.

If you have a lot of money, you could just buy your dream home and then put your current house on the market. Through bridge financing you can use the equity in your first property to finance the purchase of the next. It's the riskiest option financially, but it guarantees that you get the home you absolutely want.

Buying time with the closing dates

Getting the paperwork right is the next step in making a smooth transition. After you've found a buyer for your current home and found a new home to move into, you'll need to schedule each closing date, the day you transfer ownership of a property and finalize the sale. Ideally, both the sale of your current home and the purchase of your new one should close one right after the other. This affords you the most security financially — and emotionally. If it simply can't be done, the next best option is to try to extend the closing date on your purchase so that it follows the closing date of your home's sale. See Chapter 6 for details on negotiating deadlines that will work for you.

Try to avoid the last day of the month or year as a closing date. These times are particularly busy for the agencies that will be registering and filing paperwork for the transfer of ownership, termination of insurance, and the like, not to mention for the movers.

Pricing Your Home to Sell

If you price something too high, it won't sell. This is especially true for big-ticket items like homes. Potential buyers are skittish to begin with at the prospect of having to make such a big decision. If your price tag is too high, you'll scare them off right away. The key is finding the balance between reeling in the buyers at the start and getting your home's true value in the end (after negotiations, of course).

Knowing how much your home is worth

The best way to find out how much your home is worth is to ask a professional. You can hire a professional appraiser to give you an appraisal, or you can ask your real estate agent to give you a comparative market analysis (CMA), sometimes also referred to as a current market analysis or a competitive market analysis. A sample CMA is shown in Figure 4-1.

COMPARATIVE MARKET ANALYSIS

COMPARABLE HOMES RECENTLY SOLD

Address	Age	Lot Size	Floor Area	Bdrms	Bthrms	Bsmt	Listed Date & Price	Selling Date & Price	Ass.Value ('04)
312 Elm St.	55	33 x 120	2000	3	3	Full	Jul.5/05 $580,000	Oct. 20/05 $570,000	$550,000
2525 Maple St.	48	33 x 120	1956	3	2	Part	Apr.17/05 $600,000	Apr.25/05 $605,000	$590,000
4323 Pine St.	51	33 x 120	1830	3	2	Full	Jun.28/05 $625,000	Sep.14/05 $610,000	$600,000

COMPARABLE HOMES FOR SALE NOW

Address	Age	Lot Size	Floor Area	Bdrms	Bthrms	Bsmt	Listed Date & Price	Ass.Value ('04)
3737 Chestnut St.	63	33 x 112	1860	3	3	Full	Aug.15/05 $599,000	$586,000
461 Maple St.	47	33 x 123	1750	3	2	Full	Jun.2/05 $600,000	$590,000
518 Birch St.	45	33 x 120	1905	4	2	Part	Sept.29/05 $630,000	$615,000
2431 Elm St.	55	35 x 115	2000	3	3	Full	Oct. 4/05 $650,000	$620,000

YOUR HOME

Address	Age	Lot Size	Floor Area	Bdrms	Bthrms	Bsmt	Recommended List Range	Recommended Sale Range
495 Pine St.	51	33 x 120	1850	3	2	Full	625,000/$635,000	$610,000/$620,000

MARKET VALUE DEFINED: … the price expected when a reasonable time is allowed to find a purchaser when both sellers and prospective buyer are fully informed.

LISTING PRICE: … the price asked for a property, as set by the vendor. The vendor is urged to take into account information supplied and market conditions.

Sales Representative: _____ Date: October 15/05

Figure 4-1: Your real estate agent should give you a comparative market analysis that looks something like this.

As far as assessing the market value of your house, appraisals and CMAs are essentially the same. Both professionals consider all the factors influencing the worth of your property (such as location, square footage, general condition of the home, and amenities). They research the recent sale prices and current asking prices of similar homes in your area, compare the finer details, and adjust up or down to determine your home's fair market value (FMV). If your house has, say, an attached double garage, then it may be worth a little bit more than someone else's down the street that, like yours, is a three-bedroom, two-storey with four baths and a finished basement but comes with only a carport.

Most real estate agents will prepare a CMA for you free of charge. You will always have to pay an appraiser. If you're selling without an agent, definitely

hire an independent appraiser. The legal system, as well as most financial institutions, recognizes only appraisals prepared by certified professional appraisers.

Your buyer can put a clause (a condition) into the offer stipulating that it's subject to the home's sale price being confirmed by an independent appraisal. If your buyer's appraisal reveals he has offered more than your home is worth, your buyer might retract the offer, or your buyer's mortgage lender might refuse to finance the purchase.

Avoiding the three most common pricing mistakes

We know it's your home and you can ask whatever price you like for it, but we're here to tell you to proceed with caution. Your selling price heavily influences your likelihood of selling success; it can determine whether your home is snapped up by eager buyers or languishes in the classifieds for months. Here are three pricing mistakes that sellers often make.

Trying to make a hefty profit

The reasoning for setting a high price goes something like this: "If someone buys it for the high price, great, I made some money. If I have to drop the price a little to sell, then I haven't really lost anything because I still got a fair price." The problem is, it doesn't work that way. Your home gets the most attention for the first few weeks it's on the market. If you set the price too high, you run the risk of buyers bypassing your home due to its high price. If your home isn't fairly priced for those crucial first few weeks, it may become stale by the time you do lower the price. Buyers see your listing and think, "If it's been on the market for this long and they have to keep lowering the price, there must be something wrong with it." They may then turn around and purchase something else by the time you lower your price.

Furthermore, if the initial asking price is too high, the buyer won't feel that competition for the home exists — and this means they won't be in any hurry to make an offer. Either way, by the time you do lower the asking price, agents (and their buyers) have lost interest in your home and you may have to sell for less than you would have gotten had you priced your house realistically in the beginning.

The only real circumstance where you can be "optimistic" in your asking price is in an overheated seller's market where few, if any, homes directly compete with yours. In this dream-come-true scenario, you can ask a higher price than your CMA would otherwise indicate. Better yet, you may get offers

from competing buyers, driving the price higher than what recent sales would indicate your home is worth.

Setting the sale price based on your needs

Many sellers have a new location (or even a new home) in mind and know how much money they need to make on the sale of their current home in order to purchase a new one. Other sellers may be planning to "trade down" as a way to make money they can then invest for retirement. Frankly, buyers don't care about your needs. Buyers have their own needs to worry about, one of which is paying fair market value for their new house. If you keep the sale price too high because you need the money, you simply won't be able to sell your home.

Setting the sale price based on how much you have put into your home

Thirty thousand dollars' worth of renovations does not necessarily equal an extra thirty thousand dollars on the sale price of your home. Some improvements to your home will increase its value, and others will not (for example, kitchens and bathrooms are often the best places for renovations that add to the resale value of a home). Cosmetic improvements, such as fresh paint, are always good investments. Although they will not increase the value of your home by a significant margin, basic home touch-ups are relatively cheap and extremely important for making a good first impression on buyers. You only get that one chance to make a first impression. A good agent will know what counts and what doesn't, and so will most buyers — you can also see Chapter 6 to find out which renovations are most valuable for sellers.

Estimating the Costs of Selling

On the surface, the economics of selling your home seem pretty simple. You sell your home and, hopefully, you make enough money to cover the purchase of another one. If the sale price of your current home is greater than what you pay for your new home, "I save money" appears to be the logical conclusion. Unfortunately, a few steps in the middle of the process may shrink your profits from the sale. With proper planning, you can accurately estimate the proceeds of the sale to find out for sure. This section takes you through the expenses you are responsible for as the seller.

After you have investigated the anticipated market value of your home and each of the costs we describe here, you've done the hard part. Just fill in Table 4-1 to determine the net proceeds you'll realize from selling your home. Start with your home's estimated sale price and subtract whichever associated costs apply. What you're left with are the net proceeds from the sale.

Table 4-1 Calculating the Net Proceeds from the Sale

Item	*Amount*
Estimated sale price	_____
– Agent's commission	_____
– Legal fees	_____
– Repairs or renovations	_____
– Discharge of your mortgage	_____
– Property taxes and prepaid utilities +/–	_____
– Moving costs	_____
– Survey fees (if applicable)	_____
– Appraisal fees (if applicable)	_____
– Location-specific expenses (if applicable) (termite inspection, well water inspection)	_____
– GST (if not already included)	_____
Net proceeds from sale =	_____

Agent's commission

Unless you have time and energy to burn, chances are you'll hire an agent to help with the sale of your home. Your agent receives a commission when you sell — usually a percentage of the sale price — as does your buyer's agent. And guess what, you are responsible for both! A typical total commission expense might be between 4 and 6 percent of the selling price, but rates are negotiable. If you decide to sell privately you will probably still deal with buyers who are using an agent, so you may get stuck with some commission fees no matter what.

Legal fees

The sale of a home requires complex legal documentation. You may need a notary or lawyer to draw up or check over all paperwork and documents. Depending on the amount of work to be done, your legal fees will vary. Talk to

several lawyers to get an idea of how much your case might cost, but budget at least $600 to $1,200, including conveyance (the transfer of the title to the property), and more if you need documents to be drafted by the lawyer.

Repairs or renovations

Most homes will not require major renovations to ensure a sale. If you've kept your home in good shape or if your home is relatively new, you may need to do only minor repairs. First impressions go a long way — no matter how new your home is, pay attention to cosmetic details (chipped paint, leaky faucets, loose doorknobs, and so on). The better your home looks, the quicker it will sell.

Your buyer will have a building inspector inspect your home (for plumbing and structural problems, and so on) to find out what improvements (if any!) are necessary. Whatever repairs are needed may be deducted from the selling price, likely with a margin of error that will benefit your buyer. In some circumstances you may wish to have your home inspected, perhaps if you suspect a serious problem exists, or if you live in an area where properties, often condos, are commonly listed as having a "positive inspection" available to potential buyers. Other people use their inspections as a marketing tool to demonstrate how "good" their homes are and thereby to get top dollar for them. If you're selling a condominium and the building has a positive engineering report, you have an excellent selling point — use it. A glowing inspection report from a reputable agency provides an incentive to potential buyers. However, if the inspection reveals any serious liabilities, you are legally obligated to disclose that information to potential buyers.

No right answer exists to the question of whether you should absorb the cost of the building inspection. You may be wasting your money because the buyers will probably have their own inspection done anyway, but you could see some benefits at the negotiating table. Talk to your agent, if you have one. If you choose to have your home inspected, remember to include the inspection fees when totalling the cost of repairs and renovations.

Discharge of your mortgage

If you don't have a mortgage, give yourself a pat on the back and skip ahead to the next point; otherwise, read on! Most lenders have a few options available for handling your mortgage when you sell, depending on the specifics of your current mortgage agreement. You may be allowed to take your mortgage with you to your new home, you may be able to let the buyer assume it, or

you may be able to pay it off early. You may need to state in your sale agreement that you rely on the buyer's money to pay off your mortgage so you can deliver your home with a clear title to the buyer. (Find out about the options in the section "Dealing with Your Current Mortgage" in this chapter.)

Lenders often charge legal and/or penalty fees when you choose one of these options. Check your mortgage agreement to see what is permitted and talk to your lender to find out what fees you might incur. Fees are sometimes negotiable. If you've been a loyal client of your lender for many years, you may be able to "talk down" a prepayment penalty, especially if you have a credit card and a chequing account and mutual funds with the same lender, but don't hold your breath. Many lenders have a policy against renegotiating. Whatever arrangements you make with your lender, be sure to get a copy in writing.

Property taxes and prepaid utilities

The day you usually pay your property taxes is not likely to coincide with the day you sell your home (if Fate loves you that much, skip ahead to the next point). In the sale contract, there will be an adjustment date (the day the buyer assumes all responsibility for paying property taxes, and so on). Usually the adjustment date is the same day as the possession date, or the day you hand the buyer the keys. In effect, your buyer may owe you a refund on a portion of your annual property tax (or you may owe the buyer some money if you don't prepay your property taxes). Likewise, any prepaid utilities, condo fees, or assessments need to be reviewed. Your lawyer can work out exactly how much is owed to whom and adjust the taxes as part of the conveyance or statement of adjustment. (The statement of adjustment shows the net result for the vendor [seller] or purchaser of the home, taking into account the purchase price, deposit, real estate commissions, legal fees, property purchase tax, condo fees, property taxes, and all other adjustments.)

Moving costs

Obviously, how much it costs to move depends on how much stuff you are moving, how far you are moving it, and what moving company you hire. Other factors may enter into the tally, including the time of year and any "special care" items you may be moving (such as your baby grand piano).

Do your research. Find out exactly how much stuff you've accumulated over the years and how much it's really going to cost to get it to your new home. An extra few hours assessing the contents of your basement and garage, plus

a phone call or four, are a lot less hassle than under-budgeting your moving costs by several thousand dollars, or finding out too late that your one-bedroom home has three bedrooms' worth of memorabilia (two-thirds of which will not fit into the moving truck). You might also need to rent temporary storage space.

Survey fees

Some lenders require a survey in order to approve a mortgage on a house. (No surveys are required for condos; most condo buildings have a building or strata plan that shares the square footage of the unit in lieu of a survey.) Usually, this cost is absorbed by the buyer (as you probably already know), but it's not uncommon for sellers to have an existing survey certificate from when they purchased the house. If no alterations or additions have been made to the property, it may still be acceptable to the bank. The fee for having a survey done depends on the size and particularities of your property (be warned, it could cost up to $1,000).

Appraisal fees

You need to know the value of your home before you set the selling price. If you're not using an agent, you may want to hire a professional appraiser for an expert opinion of how much your home is worth. (Your buyers will still have a second appraisal done — their mortgage lender may require it, or they may simply want to be certain they are getting a good deal.) If you're using a reputable and experienced agent, you may not bother with a pre-listing appraisal.

Don't confuse an inspection with an appraisal. An inspection reveals any major structural or systems-related problems with your home that will need to be fixed before you sell; an appraisal investigates what the market value of your home is. The appraiser may take into account whether any of those problems the inspector looks for exist, but he is really only interested in the dollar value on the bottom line.

Location-specific expenses

Some geographic regions come with their own unique set of housing issues. As a seller, you may be responsible for extra costs associated with your particular region.

Believe it or not, Canada has termite hot spots. If you know you live in a hot spot, you may want to have a termite inspection performed. Insects and other pest problems may be part of a standard home inspection. If you live in a region notorious for pest infestations, you may have to pay for a separate inspection. It is possible in some cases to get a termite warranty. If you have one, and keep it active, it may cover the cost of the inspection.

As a rural dweller, you may want to have the well water tested or a modern filtration system installed. As a resident of Nova Scotia, you may want to have the results of a recent ground test for radon handy for showings. Maybe you live on a fault line or maybe you live on a flood plain. Wherever you live, be aware of the extra expenses you will incur due to your location.

GST (Goods and Services Tax)

Regardless of whether the sale of your home is GST exempt, this tax applies to most services you will use in selling your home. So expect that real estate agents, lawyers, notaries, appraisers, building inspectors, surveyors, and anyone else you hire to help sell your home will charge GST on top of their service fees.

Selling your home is an expensive endeavour. Unfortunately, money is not the only currency associated with selling. You're also going to spend time — lots of it. We can't supply you with the numbers in discussing all the expenses you will encounter when selling your home; you need to figure them out for yourself. This is because each situation is different and each requires investigation, which will eat up many hours. The old saying that "time is money" certainly applies when it comes to selling your home. Many aspects of home-selling can't be done on your own, and you must take on many other tasks yourself. Anything you pass off to someone else will cost you money; anything you don't will cost you time.

Dealing with Your Current Mortgage

What happens to your current mortgage if you decide to sell your home? You have three choices:

- Pay off your mortgage.
- Let your buyer take over your mortgage along with your home.
- Take your mortgage with you to your new home.

When your parents were buying their first house they probably had to beg and pray for a mortgage. Times have changed. Today's mortgage market is buyer-driven. Instead of crawling into the bank on your hands and knees and pleading for your mortgage, you can stand tall and ask potential lenders, "What can you do for me?" Here are a couple of items the lender may offer you:

- A .5 to 1 full percentage point reduction off the current interest rate if you're looking for a new first mortgage on a property (it doesn't matter how many mortgages you've had in the past on other properties — only the home you're looking to buy is in question here).
- A legal package that allows you to use the lender's lawyers, at a discount, for the conveyance of the title and preparation of the mortgage documents. The conveyance of title is the transfer of ownership, the registration of the new owners, and the registration of the mortgage, at the appropriate land titles office.

Before you make any final decisions, shop around and negotiate. Money is a commodity, and some lenders will charge you a higher price to use their money than others will.

Paying off your mortgage early

If you've owned your home for a long time, you may have built up substantial equity. Equity is the difference between the value of your property and the outstanding debts against it — for example, if your home is worth $250,000 and you have paid off all but $12,000 of your mortgage, you have accumulated $238,000 worth of equity in your home. If you have only a small portion of your mortgage to pay off, you might consider discharging it (paying it off early).

Most lenders offer financing plans to help you discharge your mortgage faster while avoiding high penalty fees. A financing plan may allow you to do one of the following to help discharge your mortgage more quickly:

- Increase the amount of your mortgage payments.
- Make mortgage payments more often.
- Exercise "prepayment" options (prepayment means you can pay a certain amount of the principal each month or each year in addition to your regular payments, or a percentage of the principal can be paid down each time you renew your mortgage terms).

Using any of the above options decreases the length of time it takes to pay off your mortgage. (We discuss mortgages in detail in Chapter 1.)

If you're a long-range planner and you're considering selling your home in the next five years, talk to your lender to see about renegotiating your terms. You may be able to modify your payment schedule or negotiate a mortgage renewal that permits you to discharge your mortgage as soon as possible, without paying a penalty fee (you pay this fee to your lender as compensation for paying off your mortgage early).

If you want to pay off your mortgage with a single cheque, you will likely pay a penalty fee. The amount of a penalty fee is usually equal to either three months' interest or an interest rate differential, and the bank will charge you the higher of the two. If interest rates have gone down since you signed on to your mortgage, your lender stands to lose a portion of the interest money when you pay off the loan early. For example, if you're making payments on your existing mortgage at a 5 percent interest rate and the current rate is 3 percent, your lender will charge you for the 2 percent difference. Because the lender can only charge the current 3 percent rate on any loans it currently negotiates, the 2 percent rate differential penalty accounts for the reduced profit your lender will make on new loans, as compared to your original loan.

Some financial institutions may negotiate the mortgage penalty fees if your buyer also takes out a mortgage with them, or if you use the same lender for your next mortgage, but don't hold your breath. Whatever arrangement you make with your lender, get it in writing.

Letting your buyer take over your mortgage

If you're trying to sweeten the deal for a potential buyer, and your mortgage rate is lower than the current rate, consider taking advantage of the "assumability" option. Basically, you allow your buyer to assume your mortgage at its existing rate when he purchases your home. Assumability is often restricted to fixed rate mortgages. (See Chapter 1 for a discussion of fixed rate and other types of mortgages.)

Assuming a seller's mortgage is rare, however. Generally, if circumstances make your mortgage look attractive to a buyer, it's probably a mortgage you want to hang on to, rather than approaching a lender for a new mortgage at the higher current interest rate. The only scenarios that truly warrant considering the assumability option occur (1) when you've got a great mortgage and your highest priority is selling fast (and you can afford not to take that great mortgage with you), or (2) if you're in a tough buyer's market and the incentive of a below-market mortgage rate will help you sell your home.

Here's how the assumability option works. Your buyer must meet your lender's credit requirements before your lender approves the mortgage transfer from you to your buyer. There may also be fees (which could be hefty) for the legal work and paper shuffling required. Fortunately, because most lenders now require your buyer to meet their credit and income standards, you no longer risk taking financial responsibility if your buyer fails to pay the mortgage in the future, as was the case in the past in some provinces.

If your buyer assumes your mortgage, you benefit in three ways:

- An assumable mortgage is a marketing tool; it may be just the enticement a buyer needs — the lure of a lower interest rate.
- Because your lender is already familiar with your home, the home appraisal requirement may be waived, saving the buyer a few hundred dollars and making your home more enticing to the buyer.
- If the buyer assumes your mortgage, you're no longer responsible for the discharge penalty fees, saving you even more money.

Do not take it for granted that you will be absolved of all responsibility if the new owner defaults on mortgage payments! Make absolutely sure to indemnify yourself — get it in writing that you have no further financial obligations with regard to the mortgage after your buyer assumes it, and that you are fully discharged from the mortgage. Use your lawyer or notary.

Taking your mortgage with you to your new home

Most mortgage agreements have a portability option that allows you to apply your current mortgage to a new home if you decide to sell. "Porting" your mortgage may be your best alternative if there's too much still owing on your mortgage for you to consider paying it off immediately, and if your existing mortgage rate is lower than the current rate.

Often, only fixed rate mortgages are portable. If your new home requires extra financing, you can usually borrow additional funds at the current rate — your new mortgage rate will be a blend of your mortgage's existing interest rate and the current interest rate. For example, if you have three years left on a five-year mortgage term, you may be able to borrow the extra money at the current three-year rate. (So the additional $20,000 you borrow to finance your new home will fit into your existing mortgage at the current three-year rate.) The additional mortgage you just took out to finance your new home has the

same expiry date as your original mortgage. When the time comes to renew them, you renew them as one mortgage.

Porting mortgages has become quite common due to the low interest rates of recent years, but choosing what's best for you always depends on your unique financial situation and how much risk you are willing to take. If you've taken to following the rise and fall of mortgage rates religiously in the past few years, you may feel confident in allowing your buyer to assume your current mortgage so that you can take out a new variable-rate or short-term open mortgage on your new home. (See Chapter 1 for details on variable rates and open and closed mortgages.) If you can stand the headache of renegotiating your mortgage every six months, you'll probably end up saving money in the long run.

If you're not a risk-taker and can't be bothered to scour the financial section of the newspaper every morning for the latest trends in mortgage rates, it's worth the bit of extra money you may pay to port your fixed rate mortgage, just for the peace of mind.

If you're wondering about the benefits of porting your existing mortgage to a new home, you can check out the financial consequences online. Surf the Internet — find a Canadian online mortgage calculator (try `www.canadamortgages.com` or `www.canequity.com`) and pretend you're going to port your existing mortgage and borrow a bit more at the current rate. The calculator will determine your new blended interest rate, and tell you what your payments will be. You can simply multiply your monthly payments by the number of months in the mortgage term to get the total amount you'll pay if you port your mortgage.

Use the mortgage calculator a second time to figure out the total amount you would pay on a new mortgage at whatever the current interest rate happens to be. If the total amount payable for a new mortgage is less than you would pay by keeping your current mortgage with a new blended interest rate, then you stand to save if you pay off the current mortgage rather than porting it to your new home. Just be sure the savings you will make with the new mortgage are greater than the penalty fee you'll be charged for paying off your current mortgage early.

Reversing your mortgage

If you need extra income to help maintain your current standard of living after you retire, or if you need extra income for personal care expenses, you may want a reverse mortgage. A reverse mortgage is an agreement between

you and a lender that allows you to tap into the equity built up in your house. You can do this in a few different ways: Your lender may give you a lump-sum payment, send you monthly payments, offer a line of credit, or offer some combination of these options.

Some standard restrictions exist on who can enter into a reverse mortgage agreement — usually, you must be at least 55 years old and have no outstanding debts against your house. However, you do not need to meet credit or income requirements to be eligible for a reverse mortgage. In Canada, reverse mortgages are offered through the Canadian Home Income Plan (`www.chip.ca`) as well as by a company from New Zealand now operating in Canada called Seniors Money Canada (`www.seniorsmoney.ca`).

The amount of money you can access ranges from 10 to 48 percent of the value of your house. The total amount of funds you can access is determined by

- The value of your house
- Your age
- Current interest rates
- The type of reverse mortgage you choose

Unlike a conventional mortgage, a reverse mortgage does not have to be repaid right away — repayment starts when your house ceases to be your principal residence (a house is no longer considered a principal residence if the borrower moves, dies, or sells the home). When you do begin to repay the mortgage, you are responsible for the borrowed principal plus all the accrued interest and any other legal or administrative fees associated with the agreement.

The amount you must repay for a reverse mortgage cannot exceed the value of your house, and you cannot be forced to sell your house to repay the mortgage if you still reside there. When lenders determine the amount a borrower can receive, they're betting that the house will not depreciate significantly and that the borrower will not reside there so long that payout exceeds the value of the house.

Repayment can be made by you, your family, or your estate, and need not involve the sale of your house. If you do decide to sell your house, whatever profit you make over the market value of your house is yours (or your family's, or estate's) to keep. Should the sale generate less than the value of the reverse mortgage on your house, it's usually the responsibility of a third party, such as an insurance provider, to make up the difference.

Although not many homeowners have taken out reverse mortgages, the popularity of this option is growing. If you feel it's important to pass down your home to children or grandchildren, you may not want to experiment with a reverse mortgage.

Many seniors consider a reverse mortgage because they cannot pay all the bills required to maintain their house. Seniors should investigate whether they can defer their property taxes, which would mean one less hefty bill to pay each year, and may allow them to postpone or eliminate the need for a reverse mortgage. If property taxes are deferred, they are generally repaid when the homeowner moves out of the property, or when the house is sold.

Chapter 5

Preparing to Sell Your Home

In This Chapter

- Selecting an agent
- Deciding to sell your home yourself
- Selecting a lawyer
- Understanding the listing contract
- Making disclosure statements

This chapter contains the most "for sale by owner" information, because it not only outlines the steps in putting your home on the market, but also contains lots of useful information for everyone. From choosing an agent (if you want one) and a lawyer, to getting an appraisal or inspection, as well as completing all the contracts, statements, and steps in between, this chapter gets you from the decision to sell to the point where you're ready to talk to potential buyers.

If you're a take-charge kind of person with some time on your hands, you may be considering selling your home privately. Wait just a minute, though! You need to know what's in store for you in the home-selling process. Read this chapter to be sure you're making the right decisions, whether you want a real estate agent to handle your sale or you're determined to do it yourself. An experienced lawyer who specializes in real estate will ensure everything goes smoothly, whether or not you're using an agent. If you want to sell your home on your own, you'll rely on a real estate lawyer or notary to draft and review all your documentation. Either way, make sure you have the right kind of help to secure your home's sale.

Identifying the Right Real Estate Agent

Most people approach the task of selling their home as a team sport. Make things easy for yourself by picking the best players to back you up. The most important positions on your selling team are your real estate agent and your

real estate lawyer. Choose both individuals with care. In this section, we take you through the ins and outs of finding the best agent. We do the same for finding a lawyer a little later in this chapter. Another potential member of your selling team is your real estate agent's broker. See Chapter 2 for more on the relationship between you, your agent, and your agent's broker.

Real estate agents, also known as salespeople, representatives, or registrants in some provinces, can use the term Realtor provided they are registered members of their local real estate boards or associations. The word Realtor is actually a registered trademark of the Canadian Real Estate Association (CREA), and only members in good standing with CREA can use the term Realtor. This means they are licensed professionals and are legally bound to protect and promote your interests as they would their own.

Picking the perfect real estate agent for you is partially luck and partially knowing what to look for. We recommend you interview several candidates before you make a decision.

What to look for in your agent

The best real estate agents score high on the list of qualities below. Keep these in mind when you're asking more targeted questions during your interview (we give you a list for that as well, later on in the chapter). Your agent should

- **Be a full-time professional.** When you sell your property, you hand over a sizeable amount of money to your real estate agent — probably anywhere between 3 and 6 percent of the price, and up to 10 percent on smaller recreational properties. A good agent earns a commission by giving you good advice, promoting and marketing your property, skillfully closing the deal, and taking care of the details. To do the job right, you need a full-time professional. A big part of selling a home is being in contact with many buyers and understanding what they respond to. Don't settle for anything less than a dedicated, full-time real estate agent.
- **Charge a reasonable commission rate.** Find out what commission the agent charges on a sale. Is the agent's commission rate in keeping with the range you have been quoted by other agents? A range of commissions is charged across the country and commissions are calculated differently in different areas and by different companies. In Toronto, a seller may pay a 4 to 6 percent commission. In light of recent housing market jitters, we have seen some cases in the Toronto area where commissions can be negotiated down to 3.5 percent. By comparison, in Vancouver, many companies charge a 7 percent commission on the first

$100,000 of a sale and 2.5 percent on the balance. The British Columbia housing market, especially in Vancouver, is also due for a moderate correction, and may see more commission rate flexibility as well. Some discount companies work for a flat fee commission ($5,000 or $10,000) or a flat percentage (as low as 1 or 2 percent). Although the market for most recreational properties is very active, more remote properties have traditionally been more difficult to sell than conventional, more accessible properties, so commissions may be as high as 10 percent of the sale price for that remote cabin in the woods with water or float plane access only.

The agent willing to accept the lowest commission isn't necessarily going to do the best job of selling your home. Occasionally a company that charges a lower commission requires the owner to pay for all advertising (including, occasionally, buying a sign from the agent!), as well as do all their own showings and even host the open houses. Sometimes a company quotes a low commission to secure a listing and, after the house has been on the market for a month or so, recommends you pay a higher commission for more services. Suddenly the commission looks pretty much like all the other quotes you found. Also make sure the commission quoted allows for a commission to be paid to a buyer's agent. Make sure the total commission quoted is all you will be paying . . . you don't want any surprises.

- **Inform you how she handles holdover clauses as they apply to commission.** In some rare cases, you may still owe your agent the commission even if your home doesn't sell while you have it listed with her agency. Your agent can use a holdover clause to claim a commission even if your home's sale happens after the listing expires. An average holdover period might last 60 to 90 days from the expiration of the contract. Occasionally, a buyer who made an unacceptable offer on your house while it was listed may approach you again when the listing has expired, this time with an acceptable offer. Depending on the timing of the offer and the wording of the listing contract, you may still have to pay your agent the commission. Check the fine print of the listing contract to see if a holdover period applies, and ask your agent if her company has ever enforced the holdover period.

If a real estate agent doesn't negotiate a fair and equitable commission for himself, will he negotiate a good price for your house when dealing with buyers? If you're looking for a good deal overall, the commission might not be the best place to cut corners.

- **Quote a reasonable listing price for your home.** Beware the agent who quotes the highest listing price. When you interview real estate agents, ask them what listing price they think they would assign to your home, and ask how they determined this price. For the most part these days,

home listings across Canada no longer invite multiple offers. The credit crunch and the resultant economic mess have made sure of that! You can ask about price determination as a casual conversation at the first meeting with the agent, or you can ask the agent to prepare a complete comparative market analysis (CMA) and discuss pricing in more detail after the agent has viewed the property and returned with the complete CMA. You'll quickly sense how knowledgeable the agent is about homes in your neighbourhood, as well as the real estate market in your price range. Take a look at Chapter 4 for more about CMAs and to find out how you can get a pretty good idea of what's reasonable . . . and why pricing your home too high initially is a big mistake.

- **Have a good track record.** Ask the agent how many years she's been working as a real estate agent. Ask for references — get the names and numbers of at least three people whose homes she's sold in the past year or two. Call the references your agent provides. If the people you speak to have mixed feelings about the way the sale was handled, find out what went wrong and how, looking back, they would have prevented it. Hindsight is always 20/20. What questions will they ask real estate agents the next time they are preparing to sell?
- **Be local.** If you're selling a starter home in the suburbs, the best real estate agent in the neighbouring city isn't the right choice for you. You want an agent who works full time in your area. Your agent's networking and connections are, in fact, very valuable marketing tools available to you. The more local agents (and therefore buyers) your agent works with, the larger the pool of potential buyers for your home.

  Working with your local real estate star, you'll see that the agent knows your neighbourhood inside and out. A well-versed local agent knows what home buyers are after, and how to showcase your neighbourhood and community. Chances are, the agent has a good idea how to sell your home from the moment she pulls up to the curb.
- **Sell houses like yours.** The agent who sold the largest number of local monster houses last month is not the best candidate to sell your starter home. Hire an agent who lists and sells lots of other starter homes — someone who's constantly working with people in the market for a home like yours, and who understands which buyers will be interested and what features those buyers are looking for.
- **Make selling your home a priority.** Be alert to signs the real estate agent won't have time to personally work on marketing your house. Some top-selling agents just have too many listings to personally take care of your property. Their assistants take care of the legwork, attend open houses, and schedule showings. You don't want to find out part-way through the process that the agent you so carefully selected has delegated your listing to an assistant.

  But, a busy agent is busy for a reason. If your real estate agent has many listings, that means many phone calls to show and sell all his listings. If your agent is in demand, he's probably a good one.

Similarly, you don't want to list your home with an agent whom you'll never see again until the listing is ready to expire and they swing by to renew the contract. If the agent is planning an extended vacation in the near future, don't use that agent! Sometimes selling your home takes longer than you think it will, even when the price is right. For all the work you're doing to keep your property looking its best, you don't want to let buyers slip through your fingers while your agent is cavorting with the locals in Bora-Bora.

- **Be Web-proficient.** The Internet is a great tool and is constantly changing how the real estate market works both in Canada and internationally. An agent who has been inspired to be proficient on the Web is an agent who can adapt and innovate along with the times.
- **Have specific ideas for marketing your home.** You can even request a written marketing plan from each of the real estate agents you interview. The marketing plan should include the listing price for your home, a list of comparable properties on the market, recommendations for making your home more marketable, plans to advertise and promote the property, and details on how the agent intends to manage open houses.
- **Be enthusiastic about the prospect of working with you to sell your home — from start to finish!** If your agent isn't excited about selling your home, how enthusiastic will he be when he's showing the house to potential buyers . . . and how thrilled will potential buyers be when he shows the house in a very lackadaisical and lazy manner?

Build a list of real estate agents to interview. When you've decided to sell your home, you'll start to notice For Sale signs and Sold signs posted on people's lawns. Take a walk around the neighbourhood and write down the names and phone numbers of the agents who have the most signs up. The more Sold signs the better. Presto! You have a list of agents who are clearly active in your neighbourhood and skilled at closing deals. If an open house is happening, take the opportunity to meet the agent. Interview the agents on your list. Talk to people you know who have bought and sold homes recently. Add to your list the names and numbers of local real estate agents who come with good recommendations.

What to ask your agent

After you've got a healthy list of agents to interview, consider some of the following questions that will quickly narrow it down:

- Are you a full-time real estate agent?
- How long have you been in the business?
- What area do you work in primarily?
- Do you use the Internet as a sales tool?

- Do you have a Web site?
- Do you have access to the real estate portals such as www.mls.ca?
- Do you take colour digital photographs of homes to post online?
- Do you typically sell homes in any specific price range?
- What asking price would you recommend for our home?
- How did you determine the asking price for our home?
- What specific ideas do you have for marketing our home?
- Would you be present at all showings of our home?
- Do you use lock boxes? If so, how do you log visits?
- How many local homes in our price range did you sell last year?
- Can I get the names and numbers of three people whose homes you sold in the past two years?
- How will you keep me informed after my home goes on the market?
- Have you been sued? If so, why?

Choosing to Go It Alone

If you decide to sell your home without a real estate agent, your greatest asset is recognizing what you know and what you don't, what you can do yourself, and what you should delegate.

Realize that selling a home privately is an extreme sport. In between answering the phone, scheduling appointments, verifying potential buyers' identities, confirming their qualifications with financial institutions, and showing off your home, you need to maintain a perfectly groomed house and lawn. You may also be trying to raise a family and hold down a job at the same time. Your lawyer is indispensable when it comes to arranging a title search, negotiating with buyers, and reviewing legal contracts. (More about your lawyer later in this chapter.) Fair warning: Selling your home yourself is a time-intensive undertaking.

And the stakes are high. Selling your home is a business transaction and a legal transaction, involving your largest single investment. When it comes to marketing your home, negotiating with sellers, and dealing with contracts, you have to make a lot of decisions and do a lot of work that most people rely on their agents to do.

We want you to be realistic and prepared to deal with all the complexities of making a private sale. In this section, we help you determine your limits so you know which aspects of home-selling you can handle, and how to find a lawyer or agent to take care of the home-selling processes that you can't.

Saving the commission

The big reason why people like the idea of selling their homes privately is the money savings they anticipate. By selling privately, you will not pay a commission (percentage of the sale amount that goes to the agent who makes the sale). Commissions vary across Canada and from agent to agent, but they tally in the thousands. We describe the ranges of commissions agents make across the country in "What to look for in your agent," above — and don't forget the additional 5 percent Goods and Services Tax payable on the total gross commission.

Selling your home yourself will probably cost less than a tenth of what you will pay if you hire a real estate agent to make the sale. However, if your buyer has an agent, then your savings won't be as great because the buyer's agent will want a commission to assist in the sale.

If you want to sell your home yourself to save commission on the sale, you have to work hard. The closer you can match a real estate agent's professionalism, price your home realistically for the current market, and focus on getting the property sold, the more you can save. Just remember that during private sales, often the seller and buyer both want to save the commission money, which may lead to some interesting negotiations.

Working out the costs of selling it yourself

We know you're visualizing what you can do with all that commission money you save by selling your home yourself. Well, take those dollar signs out of your eyes! Here are the expensive and troublesome realities you face if you plan to sell your home privately:

- **You may have to lower the asking price for your home.** If a buyer is considering two identical properties with the same asking price, one being sold by the owner, one by an agent, unless you can offer your buyer a better price, chances are he'll take advantage of the expertise and facilitation provided by a real estate agent.

- **You incur the cost and hassle of advertising that your home is for sale.** You will actually have to sell your house before you cash in on your saved commission. In order to reach buyers, you need to drop a significant amount of money on advertising because you won't have access to the Multiple Listing Service (MLS) and all the contacts an agent would provide. The cost of advertising in local and regional newspapers quickly adds up. The good news is that for a minimal fee you can post your home for sale on a number of "For Sale by Owner" Web sites — the trick is to find out which sites potential buyers are surfing. You will also have to try to keep on top of what similar homes are selling for in your area — make sure you can track selling prices on the Web sites you choose.
- **You are responsible for researching and accurately determining the right price for your home.** Pricing your home is very important. (See Chapter 4 regarding comparative market analysis and potential pitfalls when setting the price for your home.) If you hire an appraiser to assess the current market value of your home, expect to pay between $150 and $300 for this service. A real estate agent may offer you a comparative market analysis (CMA) free of charge to try to get you to list with them. A CMA states what your home is worth (its fair market value, or FMV) based on comparisons to similar homes currently for sale and recently sold in your area.
- **Selling your home on your own is not going to fit neatly into a schedule.** You must be very accessible — by phone, by pager, or online — if you're going to sell your home privately. Expect prospective buyers to knock at your door at all times of day and night . . . regardless of how large the words "By Appointment Only" appear on the For Sale sign in front of your home. You will have to accommodate the needs of prospective buyers' schedules in order to show the home, and if you have a family, you also face juggling their schedules. When you sell privately, you don't have the luxury of a real estate agent who organizes and administrates the showings of your home.
- **The legalities involved in selling a home are considerable.** You may not be aware of special legal considerations when selling your home, and you could risk being held liable by the buyers. An experienced agent is on the lookout for any possible legal issues — after all, her commission and her reputation are at stake if something goes wrong with the sale of your home. And if she by chance overlooks a legality, she has errors and omissions insurance to cover her — you don't! (See Chapter 2 regarding an agent's roles and responsibilities.)
- **Emotions may cloud your judgment.** You need to be professional and objective during negotiations with your buyer. Your personal attachment to the property may prevent you from being an effective negotiator. If you don't have experience at a bargaining table, you're probably not the

best person to haggle with a potential buyer's experienced and well-informed real estate agent.

- **Real estate agents will see your "private sale" advertisements in the newspaper and they'll be calling you, too.** Like any ambitious businessperson, real estate agents look to expand their business, and they're in touch with the market. When your home appears available, agents will solicit you, hoping you're tired of dealing with the headaches of trying to sell your home yourself and will hire them instead.

Hiring a Good Real Estate Lawyer

In case you're wondering whether you need a real estate lawyer to help with the sale of your home, the answer is yes. Emphatically, YES! Law school takes years to get through for a reason — because laws are complex and sophisticated. No matter how smart you are, you need a professional. Period. Your lawyer performs a number of necessary tasks to cement your home's sale, tasks that you don't have the knowledge or resources to accomplish — unless maybe you're a lawyer yourself.

You risk losing hundreds of thousands of dollars if you try to put the sale through yourself and get it wrong. If you can spare hundreds of thousands of dollars and you really want to represent yourself, you can go ahead and gamble — it's legal. But for 99 percent of home sellers, selling their home without a lawyer's involvement simply isn't worth the risk.

At the very least, you require a lawyer (or a notary public, especially in Quebec) to handle the change of ownership for your home, even if you're selling the home privately. Don't forget, a real estate lawyer has liability insurance as a safeguard in case any problems arise with transferring the title for your home.

Picking the right real estate lawyer

Recommendations from friends, family, and business associates give you the best place to start your search for a top-notch real estate lawyer. Often banks work with real estate lawyers, and your local bank manager may be able to give you the names of some of the lawyers they use.

Your provincial law society also has names of local real estate lawyers — get a list of names and telephone numbers so you can make further inquiries. When

you call the lawyers on your list, ask them to estimate how much work will be required for your particular circumstances, and what the approximate costs will be.

Cost out lawyer's fees

When you call your lawyer to make an appointment, ask how much it will cost (as if you need to be reminded), what approximate amount you will have to bring into the lawyer's office, and the preferred method of payment. Make sure you specifically ask for the "all in" cost, which will include all your legal fees, any applicable taxes and adjustments for property taxes, and other prorated fees. Ideally, you would be able to sit down and chat with the lawyer about his fee structure and level of service and expertise. But be prepared — many busy lawyers will be happy to provide a quote for fees charged over the phone, but may not be available for an interview or consultation just to explain their fee structure.

Lawyers usually charge a flat fee for the service required (the handling of the sales transaction, for example). It's often around $250 to $500, but that's not the total cost of their legal services. You also pay disbursements and taxes. Disbursements are any fees your lawyer encounters while working for you. (Disbursement fees can include, for example, courier fees, registration fees, long-distance phone calls, reproduction costs for documents, and any other costs your lawyer pays on your behalf.) And, of course, you're responsible for the tax on any goods or services provided. An average "all in" cost for the straightforward sale of a residential property with a single mortgage, which can be discharged using the proceeds of sale, might be $500 to $1,500. The cost varies, however, depending on the complexity of your case.

Also ask what your lawyer's rates are in the event something goes wrong and you need extra services. Most of the time, extra services can be obtained on an hourly rate basis.

Know when to contact your lawyer

Most home sellers go to their lawyers after they have signed the sale contract. For simple, straightforward sales done through a real estate agent, you can safely wait to see your lawyer until you have the accepted conditional offer in hand. If you're selling privately or if yours is a complicated sale, ideally your lawyer reviews the conditions of sale prior to you signing any agreement of purchase and sale.

Definitely make the offer subject to review by your lawyer if your buyer stipulates conditions your agent views as strange, or you have a rental unit on your property and the tenants will remain when the new owners take possession. If your lawyer is also your brother, and he's willing to get out of bed at one o'clock in the morning to come over and review the offer on the spot, by

all means take advantage of your connections. Getting a professional opinion is always helpful. But if the timing doesn't allow for a trip to your lawyer's office and you're selling a fully residential property with a real estate agent, you have one mortgage, you're using a standard contract, and no unusual encumbrances or conditions exist, don't be afraid to go ahead and sign — that is, if you're happy with the offer.

Preparing to visit your lawyer

Give your lawyer all the necessary information right off the bat. When you call to make an appointment, ask what documentation you should bring. Your lawyer will probably ask for the following:

- Legible copy of the accepted offer (although if you're using a real estate agent, the agency has already forwarded a copy of the contract plus other documents to the lawyer's office)
- Latest property tax bill
- Utility bills for the past year
- All mortgage information, or your mortgage discharge statement if you no longer have a mortgage, or if you intend to discharge your mortgage with the proceeds of your home's sale
- Any transfer or conveyance documents from when you purchased the home (if you still have a copy)
- Documentation for any chattels (items you agree to leave in the house for the new owners) that are to be included in the sale and that have their own title or lease, such as a leased security system
- Any additional information relevant to the condition of your property or the title (ownership) of your property

You may be able to fax or e-mail these documents, saving yourself a trip to the lawyer's office.

Taking care of business: What your real estate lawyer does for you

After your real estate lawyer has all the relevant information, things get cracking. The role of your lawyer and the role of your buyer's lawyer are not set in stone. Although some tasks are commonly relegated to the buyer's or

the seller's lawyer, nothing's stopping you if you would like to arrange with your buyer to do things differently. As the seller, your lawyer's traditional role involves the following tasks:

- Reviewing the sale contract
- Ensuring the titles and documentation are in order for any chattels included in the sale
- Reviewing your mortgage information and performing or verifying calculations
- Reviewing your property tax bills
- Prorating to the adjustment date any annual utility costs, condominium fees, and municipality fees
- Determining if any refunds are owed to either you or your buyer, and the amount of these refunds
- Preparing a statement of adjustments
- Preparing the transfer deed
- Making sure you're in a position to deliver a clear title to the buyer on the completion date

Performing a title search and verifying that no encumbrances (or other adverse conditions) exist against the property are typically the domain of the buyer's lawyer.

Listing Contracts

If your home is going to sell, buyers have to know about it. Marketing your home involves listing it either on your own or through an agent. If you are listing through an agent, you will need to fill out and sign a listing contract. The listing contract gives authorization to one or more agencies to sell your home, and specifies how much you will pay for their services. The contract is a legally binding agreement that places obligations on both you and your chosen real estate agency. You have a few options for listing your home.

Selecting your listing type

Three kinds of listings exist: MLS (or multiple) listings, open listings, and exclusive listings. MLS listings are the most common.

- **Multiple Listing Service (MLS) listings authorize your selling agent to work with other agencies' salespeople.** An MLS listing markets your home across Canada, reaching a huge network of real estate agents. Your agent is free to cooperate with all other agencies and gives them all full cooperation and access to your home's listing. The MLS system, along with the local real estate boards that maintain it, has very specific requirements regarding cooperation between real estate agents. MLS listings are often in the best interest of the seller, as they can give your home maximum exposure to the market. The listing contract and the MLS data indicate what portion of the total commission is payable to the buyer's agent — that is, the agent who brings along a ready and willing buyer for the property.
- **An open listing authorizes one or more agent(s) to sell your home while protecting your right to sell it yourself.** Open listings are rarely if ever used in residential real estate, but are frequently found in commercial real estate where properties or businesses are made available without being actively listed through an agent. The owner may sell the property without an agent or entertain offers that come through any agent. You, the seller, don't have to deal personally with any of the agents who are working on your behalf, and if you find a buyer, you are not obligated to pay any commission fees. Often the buyer will pay the buyer's agent a "finder's fee" for locating the property, and the seller does not have to pay commission. (The buyer's agent will have an agency relationship with the buyer, but the seller has no agency representation.)
- **An exclusive listing authorizes an agency to market your home for a specified period of time.** Exclusive listings are rare. Generally, exclusive listing contracts don't allow you to sell your home yourself during the listing period, and often involve a reduced commission fee, which is a benefit to you. By bypassing the MLS system, an exclusive listing means your agent's not under any obligation to show your property to other agents. Your listing agent has more control over the marketing of your home. Usually the listing agent cooperates with other real estate agents, but the listing broker calls the shots. (Refer to Chapter 2 for an explanation of the role of a real estate broker.) As an exclusive listing, the property does not appear on the MLS system (refer to Chapter 2 for details of the MLS system) and does not get the exposure provided by the MLS database. Most sellers, however, want the extra exposure and agent cooperation guaranteed by the MLS system, and therefore sign an MLS listing.

Most people who really want to sell list their homes via the MLS system, as it gives their homes maximum exposure on the market. Because of this, many buyers' agents do not consider open or exclusive listings to be serious efforts to sell the property.

Detailing your listing contract

A listing contract is a legal document that must be signed by both you and your agent, usually via standard forms supplied by your local real estate board. All the particulars about your home appear on the listing contract; it also states under what conditions you are willing to sell, and your and your agent's obligations. Make sure you obtain a copy of your listing contract and that you put it somewhere safe (not the same safe place you put that spare house key you haven't been able to find for five years).

If it makes you more comfortable, or if you are concerned or confused about something in your contract, you can have your lawyer review it before you sign. Remember that although you are listing with an individual salesperson, the listing contract is with the salesperson's agency. (So if Suzanne Smith, your real estate agent, works for Sell That House Realty, your listing contract is with Sell That House, not with Suzanne.)

A listing contract deals with three sets of issues:

- **The exact details of the property for sale:** Your home's lot specification, size, building materials, heating and air conditioning systems, number and descriptions of rooms, and other details are presented in the listing contract. Any extra items (movable things, such as appliances or furniture) or chattels included in the sale are also shown on the listing contract. (The contract also specifies if any items are excluded from the sale of the home; for example, the chandelier in the dining room or the hot tub.)
- **The financial particulars relating to your home:** The listing contract establishes the asking price for your home, and may disclose information concerning your mortgage (such as balance, payment schedule, maturity date), property taxes, and any legal claims on your property.
- **The precise terms of employment for your agent(s):** Your listing contract specifies who's allowed to market your home and in what manner, as well as stating the time period your home can be marketed by the agent, and what you will pay the agent for marketing your home.

MLS listings all come with a standard disclosure statement so that you can reveal all your deep dark secrets — just kidding! We discuss disclosure statements in detail a little later in this chapter.

Your listing contract does not obligate you to accept any offers on your home, even if the buyer fully meets the conditions of sale stipulated in the contract. A listing contract creates an agency relationship between you, the seller, and your selling agent. Throughout the selling process, your real estate agent acts in your best interest to sell the home, without misleading or

making any misrepresentations to potential buyers. Refer to Chapter 2 for more information on agency relationships.

Disclosure Statements

When you sign the listing contract, you will likely be required to fill out a disclosure statement, also known as a property disclosure statement or in Ontario a seller property information sheet (SPIS). The disclosure statement is a legal document in which you describe your property and all other items included in the sale to the best of your knowledge. On making an offer, buyers see your disclosure statement and they must sign it to acknowledge it has been received. For MLS listings in Canada, disclosure is usually mandatory; for most exclusive listings, disclosure is recommended.

Basically, the disclosure statement informs the buyer and your agent about the condition of your home, and protects you and your agent from litigation in the event a buyer discovers some dreadful problem with your property you were not aware of. By providing detailed information on the condition of your home, you ensure your agent accurately represents your property to potential buyers. You are responsible, however, if deliberately concealed information about your property comes to light after you have signed and submitted the disclosure statement.

Who sees my disclosure statement?

Disclosure statements are designed for the benefit of all parties in the transaction. The sellers disclose what they know about the property, and the buyer receives the disclosure statement, often using it as a starting point for a professional home inspection. Both the buyer's and seller's agents refer to the disclosure statement while viewing your home, and they may point to any disclosed deficiencies when negotiating the contract.

The disclosure statement puts the onus of accuracy on you, the seller, and any misrepresentation is potentially dangerous. As the seller, you must disclose everything you know about your home, and you're obligated to disclose anything you should have been reasonably expected to know. For example, if there's a minor water leak in your basement that appears only once a year under heavy rains, disclose that there's potentially a problem with the drain tile or foundation. The buyers will inevitably find small problems you try to hide.

By signing a legal document that states you have disclosed all knowledge of the condition of your property, should a buyer pursue legal action after

becoming aware of some previously undisclosed information, you (the seller) are responsible for any concealment — usually not your agent. You are only liable, however, if you intentionally conceal information. If you don't disclose information because you aren't aware of the issue, it's simply a case of bad luck for your buyer. Your agent would be liable if she fraudulently misrepresented any details contrary to the information represented by the seller.

Bear in mind that most buyers will do a building inspection, and by doing so the buyer assumes some responsibility for the condition of the house. The buyers will do their due diligence as they inspect and investigate the house. If the sellers have completed a disclosure statement to the best of their ability, and a problem surfaces that the seller was unaware of and the home inspector missed, the buyer's dispute will likely be with the home inspector and not with the seller.

In many areas, the seller may have the option to simply draw a line through the disclosure statement and state on the disclosure form that "the seller makes no representations regarding the subject property, and the buyer is to do their own due diligence." This may occur where the seller lives out of town and has not seen the property she is selling for a couple of years. When a buyer gets a disclosure statement that has not been completely filled out, the buyer will be extra diligent in doing a home inspection, and may also be leery of a seller who is not willing to make any written representation about the condition of the property.

What do I need to disclose?

The disclosure statement deals with all aspects of your property. It asks you about both land and structures. A typical disclosure statement deals with three categories:

General information

This section is geared toward the land areas surrounding your property. You include information about the following, if applicable:

- **Public systems:** Is your home connected to public water and sewage systems, and are you aware of problems with either of these systems?
- **Rental units:** Do you have rental units, and are they authorized?
- **Encroachments, easements, and rights-of-way:** Are there any that aren't registered in your title?
- **Ownership issues:** For example, have you received any notices of claims on the property?

Structural information

Here you disclose information specific to your home itself. It may include any or all of the following:

- **Insulation and ventilation:** What kind of insulation and ventilation do you have, and are there any problems with it?
- **Electrical, plumbing, heating/cooling systems:** Again, are there any problems you are aware of?
- **Structural damage:** Is there any flooding, fire, or wind damage to your home?
- **Pests:** Have you had any insect or rodent infestations?
- **Inspections:** Has your home passed a full inspection? Do fireplaces, security systems, and safety devices meet local standards?

Additional information

This section provides blank space for extra information relevant to the condition of your property, or for explanations of any problems or conditions that have previously been mentioned, or repaired in the past.

If you're selling your condominium, you need to include information about current restrictions (regarding pets, children, rentals, or use of the condominium unit) and any future restrictions you are aware of (for example, new bylaws or proposals). You also need to disclose information about anticipated repairs or major construction projects planned for the building.

It won't help you to be dishonest when filling out the disclosure statement. Even though your buyer will be relying on the word of your agent, he will also read the sale contract carefully — and you're legally obligated to disclose any known adverse conditions in the disclosure statement that forms part of the sale contract. If you lure an unwitting buyer into making an offer by misrepresenting your property in the disclosure statement, you look foolish when the buyer does his inspection and shows you to be ignorant at best, or a liar at worst. You don't want to lose a ready, willing, and able buyer because you didn't disclose all the necessary facts on the disclosure statement. And you definitely don't want to face a legal battle if your buyer later sues you for not properly disclosing the condition of your home.

Chapter 6

Sealing the Deal

In This Chapter

- Deciding what renovations, if any, to make
- Using successful marketing strategies
- Understanding the basics of sale contracts
- Navigating your way through the negotiating process
- Considering multiple offers
- Handling backup offers

When the curtain rises on your market-ready home, you need to be prepared. Think of this chapter as your coaching and cheerleading team to help you transform your home into an open house. This chapter also offers pointers on how to handle buyers after you wow them into making offers. Finally, you work your way through sale contracts and negotiations, right up to when you pass on the keys to the new owners.

Making Your House Shine

Now that you're sure about selling your old place and finding a new place to call home, you'll start to notice a big change in your attitude. Your home — the place where you relaxed, slept, worked, ate, raised kids, and cuddled pets — will slowly become a commodity. And if you get top dollar for this commodity, you'll be in a better position to buy a great new home.

Undertaking home improvements

One of the most common selling mistakes is to make major renovations before a sale. Pouring thousands of dollars into renovations does not result in an equivalent increase in the market value of your home. Some renovations are "good" and others are "bad" in terms of a return on your investment, and you

need to know which is which before jumping in with both feet. And, if poorly executed, renovations that would have fallen into the good category or the bad category will fall into the "ugly" category and knock money off your sale price.

Improvements that save your buyer money as the new owner of your home do increase the value of your home to some degree and increase the saleability of your home. For example, making your home more energy efficient means your buyer saves on heating and cooling costs. However, this renovation will probably not return more than 30 to 50 percent on your investment. In fact, you'll get back all of what you put in for few, if any, renovations. Here are some guidelines as you spruce up your home to sell it.

- **Inexpensive cosmetic improvements, such as repainting, are always your best bet.** Select colours from a neutral, conservative palette to repaint your house inside and out. This will make your house look brighter, larger, and well maintained. Statistics show that when you sell your house, you will recoup at least 50 to 60 percent of the money you spent on painting.
- **If interior or exterior structures of your home need improvement to make it saleable, then larger renovations may be worth the time, money, and hassle.** For example, if you neglected to add an extra bathroom to go with those two extra bedrooms you built years back, and your daughters have grown up having to run across the house when nature calls, then it makes sense to add one now. As a general rule, kitchens and bathrooms are good places for renovations. Upgraded features of kitchens and bathrooms make good selling points, and on average, home sellers get about 65 to 75 percent back on the money they put into modernizing.

But if you'll never make back the money you spend, why would you even consider renovations? The fact is, if a buyer recognizes your home needs work, he'll factor into his offering price a large margin of error for the cost of renovations. You can either sell your home "as is," which means the buyer will pay a lower price and undertake renovations and improvements himself, or you can undertake some good renovations yourself before you sell. Although you may never get a 100 percent return on the money you spend renovating, you may lose less than if you were forced to drop the sale price into the "as is" category.

Sometimes renovations are simply not warranted. Even though your 50-year-old bungalow could badly do with fixing up, it might not be worthwhile if you notice that all the houses that have sold on your street have been torn down to build brand-spanking-new monster houses. If people are buying into the neighbourhood for the land, rather than for the house that sits on the land, don't waste effort and money on what will become demolition debris.

Talk to your real estate agent if you're thinking about renovating. If you aren't using an agent, a good place to go for information is the Canada Mortgage and Housing Corporation (CMHC) or the Canadian Home Builders' Association. Both organizations offer many products dealing with home renovations, and have plenty of free information available on their Web sites (`www.cmhc-schl.gc.ca` and `www.chba.ca`).

Creating curb appeal

Making a good first impression is crucial to selling your home. Potential buyers don't walk up your driveway blindfolded; their first view of your property is from the street. Your home has to look good outside as well — this is often called curb appeal. You never know who's going to drive by your front yard, so consider it part of the marketing strategy.

A big For Sale sign in front can go a long way to getting your home noticed, but you want to make sure the next reaction is "And it looks great!" You have to draw buyers in before you can dazzle them with the built-in cabinetry and the lakeside glass walls that offer the stunning panoramic view of your private shoreline. Getting the right kind of attention requires a plan of attack.

Pretty on the outside

In case you're wondering where to begin, here's a list of tasks to help enhance the exterior of your house and yard:

- Clean out the garage, and move any large, infrequently used items into storage elsewhere or sell them.
- Clean windows, shutters, eaves, doors, and mailboxes.
- Replace damaged window or door screens.
- Do any necessary repairs and touch up paint jobs.
- Get out the gardening gloves: trim hedges, trees, and shrubs; rake leaves; mow the lawn; weed gardens; tend to flowers.
- Clean oil marks and stains off the driveway.
- Ensure the garage door opener is working properly.
- Clear and clean paths, patios, and patio furniture.
- Make sure your house number is visible from the street.
- Do last-minute tidying to get rid of any clutter.
- Pick up all junk mail and free community newspapers regularly.

Pay attention to other special areas that might need improvement, such as dirty backyard pools and rusting swing-sets. Take the time to look around and tidy carefully, and don't just shove all the clutter into the garage and close the door. If a buyer decides he wants to take a peek to make sure both his mini-van and SUV will fit inside, it doesn't look good — and that could cost you a sale.

If you're planning to have an inspection or appraisal performed, now is the time to do it. As part of the spiffing-up process, you'll want to make any repairs suggested by your inspector or appraiser.

Alluring interiors

So, your home positively sparkles outside in the sunshine — great. But when a buyer moves beyond the exterior, you need to back up that great first impression with something even better inside. Just clean and tidy is fine for the outside, but you must be concerned about two extra qualities inside your home: neutrality and ambience.

If you plan to repaint, or if you're replacing countertops or fixtures, choose light, neutral colours. Painting is better than putting up wallpaper — it's much easier for a buyer who does not share your design sense to repaint than to strip wallpaper. Light, neutral paint will make rooms brighter and feel larger, and will remove some of your personality from the decor. Simple cosmetic improvements are relatively inexpensive and make a big difference in the appearance of your home.

Be prepared to show at any time of day or night, and on short notice. Keep things clean, and have a contingency plan for your family and pets in case you get an unexpected call from your agent.

Going to Market

So your home sparkles inside and out and you're ready to get the word out that you want to sell. From the sign on your front lawn to your open house, your marketing techniques are a key part of the home-selling process. Although you may be able to advertise a garage sale with a flyer posted at the end of your street, we suspect selling your home will take a bit more effort. To sell your home with the least amount of hassle — and for the highest price — you need to have a marketing plan.

Home staging: Cue the professionals

Don't worry, home staging doesn't involve you standing on your front porch reciting Hamlet's soliloquy. Home-staging professionals prepare your home to be shown, treating it like, well, a stage where the drama of home selling unfolds. And the better your house looks, the better price you will get. If the market is a little slower when you list your home, home staging can speed up the selling process by making your home the star attraction among the others on the market. If your home has languished on the market for a couple of months, you might want to call the home stagers and let them work their magic instead of reducing the asking price.

The process enhances your home's best features with appropriate colours, furnishings, and props to make it all the more alluring to potential buyers. You might find it difficult to see your home — the place where you've created so many memories — as a product. But when it's up for sale, it is indeed a product. You need to figure out ways to show that it's better than all the other products out there. Sometimes this requires professional help, even if you think you have a real flair for decorating.

Home staging (also called house fluffing) involves more than a fresh coat of paint. Home-staging professionals will evaluate every room in your house (yes, even the back area where you keep your lava lamps) and make recommendations on how to make the rooms look bigger and better, highlighting the good and hiding the bad and the ugly. They'll do the same thing for your yard. Home staging can also be a good option for vacant homes. A fully furnished home usually looks more attractive than a vacant space, so a properly staged vacant property will often sell more quickly — and hopefully at a higher price — than a vacant property that looks empty and neglected. The staging services will actually bring in furnishings, artwork, and plants (temporarily, of course) to give the home a polished look and accentuate the good stuff. Better still, if you're busy and a bit stressed, like most people selling their homes, they'll come in and do all the work for you.

If you're on a tight budget, however, be warned: Home staging can get fairly expensive. Depending on whether you want a simple consultation, major rearranging, or a complete staging, you'll need to think about how much you can afford to spend. Most staging companies offer an "a la carte" range of services, ranging from a quick rearranging of furniture to a total redo with rented furniture and accessories. Many staging companies will have a minimum term of contract (60 or 90 days, for example), and at the end of that term you can decide if you want to keep the staging furniture or pay for the decorating and consulting done to date and move on . . . hopefully, your home has sold in the initial staging period.

Ask your real estate agent to recommend a reliable home-staging service, or find out more by searching for "home staging" on the Internet.

The more professional you are about your advertising, the more trusting your buyer is likely to be. If selling with the help of a real estate agent, you'll automatically benefit from the image and credibility of the company your agent works for, and their marketing expertise.

If selling your house on your own, take a page from the real estate agent's book: A coordinated effort is better than a haphazard one. An agent will explore all avenues for sale and act like a salesperson. You should, too. Make the most of the resources available to you, type any information sheets instead of handwriting them, use professional signage, and be polite to buyers.

Your basic For Sale sign

If you have a yard, posting a For Sale sign in it is one of the best ways to attract buyers. If they're interested in your neighbourhood, buyers will tour the area looking for potential homes. Don't let them miss yours. Your sign should be prominently displayed (perpendicular to the road) and list a number where your real estate agent or you, the homeowner, can be reached. If it's a corner lot, maximize your exposure by putting a sign facing each road (provided local bylaws allow more than one sign).

Unless you put the words "shown by appointment only," your buyers may come knocking at any time of the day or night. In fact, they may come knocking at any time, regardless.

If you're selling on your own, give yourself an edge by investing in a quality For Sale sign. On the Internet, check out `www.privatelist.com` — a Web site for private home sellers — for information about spiffy signs and other issues related to selling privately. You can also look up Signs in your Yellow Pages and call local shops for quotes. The sign should say "Private Sale" or "For Sale by Owner" and include a phone number or pager number where you can be reached easily.

Advertise, advertise, advertise

The purpose of placing an advertisement is to get people to phone and book an appointment. You want to provide the basic information — like number of bedrooms, general location, kind of house (bungalow, split-level), and key selling features. Make sure you include the price, which will encourage only serious buyers to call. A good ad will tempt, but not give it all away: After all, you want to entice buyers to actually come by and see your home.

Listing in the newspaper

If you're selling with the help of an agent, you won't have to take care of writing and placing ads in local newspapers and real estate weeklies. However, you can help out your agent by identifying the key selling features of your home. Make a list of the top five or ten reasons you bought the place, and

your agent will incorporate these key factors in the ads if they help increase your home's appeal.

Weekend ads generally have a greater readership, but the best coverage is achieved by taking out both a weekend ad and a daily ad.

Check out the competition. How can you make your home stand out in comparison? Buyers read through real estate advertisements with their own criteria in mind, so put front and centre the amenities that will capture the attention of your target market. Your home's proximity to great schools, its waterfront location, the award-winning design, or an unbeatable view deserves mention in your print advertisements.

If you're selling privately, use the words "private sale" or "for sale by owner" in your ad. The potential to get a good deal through shared savings on the commission is an excellent selling feature. If you're willing to cooperate with a buyer's real estate agent, put "courtesy to agents" or "will cooperate with agents" in your ad. Some buyers will not deal directly with a seller and would prefer to have their agent contact you to coordinate a showing. Some agents will call with prospective buyers for your home, others will be interested in listing your house. Whether or not you decide to use an agent's assistance in selling your home, take the time to talk with them. An agent can offer you great advice on competitively pricing your home, and potentially assist in the sale of your home.

Many real estate agents will be pleased to work with you. If an agent brings you a buyer and you can negotiate a commission fee, you may just have a deal. And because the point here is to get your home sold, it's definitely worth considering.

Real estate agents are a home seller's number one marketing tool because they're constantly in touch with potential buyers and other agents. The majority of home sales are completed through agent-to-agent contact, not by advertisements or For Sale signs.

Reaching beyond your local newspaper

Where else should you advertise? Specialty real estate publications are the most targeted, but advertise regularly in the newspapers too, particularly the issues that run the most home listings. You may also want to advertise in national or city-specific papers, as some buyers may be relocating.

Buying a home is a serious business, so you are wise to treat it as such. Buyers will be wary of giveaways, gimmicks, or anything else that smells of double-dealing. In any advertising, be flattering but sincere when you describe your home. In the end, your home will speak for itself.

In this Internet-savvy time, many home buyers let their fingers do the surfing when they're looking into new homes. Advertising your home on the Internet is a great way to maximize your home's exposure. If you're dealing with a selling agent, ask her whether she'll be listing your home on the MLS site (`www.mls.ca`), which we talk about in Chapter 2. Find out if the real estate company offers listings on their own Web site and if they post digital photos or offer virtual tours.

Making sexy feature sheets

A feature sheet is the classy, showy older sister to the newspaper ad. Essentially a flyer that you or your agent distribute to potential buyers when they come to view your home, it includes the same basic information — kind of house, number of bedrooms and bathrooms, approximate square footage, neighbourhood, price, and contact telephone number — but it also uses colour and strong design elements to make an impressive pitch for your home.

Selling with the help of an agent? If so, chances are your agent will prepare the feature sheet for you. If you're selling privately, here are some suggestions for making up your own feature sheet:

- **Attend some open houses and ask for their feature sheets.** If you see a well-designed form, model your own in the same manner. Of course, you can't use any copyrighted text or illustrations, so don't plagiarize, but do take note of what information is specifically outlined and how it's presented most effectively.
- **Put a great photograph of your home looking its very best on your feature sheet.** If you don't already have the right shot, hire a photographer or get a talented friend to take photos using a wide-angle lens and a film type that allows for multiple prints. You may even want to use pictures of your house at different times of the year, so that prospective buyers can see how cozy your home looks with a dusting of snow and definitely how magnificent the gardens are in the summertime.
- **Ensure the pages of the feature sheet are detailed, but also readable.** Don't feel you have to fill the page completely — white space allows people to focus on the important elements of your feature sheet without feeling overwhelmed, and leaves room for note-taking. Stick to a standard, easy-to-read font for the text and a simple, bold headline. If the elements of good typography are beyond you, ask a design-savvy friend to help, or look for a professional you can pay to create the feature sheet for you.

If you have a scanner and a colour printer, you can create your own brochure. If you don't, waltz down to the nearest photocopy place; many copy shops now have computer, scanner, and quality colour photocopying facilities.

Keep a stack of feature sheets handy to give to prospective buyers who visit. A feature sheet provides a good reference when buyers are comparing homes

and gives them a reminder of all the features your home offers. The feature sheet is a marketing tool that will keep selling your home even while you're on the golf greens or taking a nap.

Showing off: The open house

The open house is your home's big day. The basic idea is that your home is open for showing on certain designated days (usually during the weekend). An open house may cut down on the number of private showings you have to give, thereby reducing the disruption to your daily life. Also, many buyers feel more comfortable and leisurely being "one of the crowd" rather than touring on their own.

Some people feel the open house serves to introduce the agent to the buying public in general, as opposed to specific buyers for your house. This may be partly true, but in the end, the more people who see your home, the more chance someone will fall in love with it. Your home should be at its best on the day of the open house, so follow our preparation tips in this chapter. If you haven't already overhauled your home, before the open house is the time to do it.

If you're selling privately, announce the times and dates of your open houses in the classifieds, and post an "open house" sticker on your For Sale sign with the appropriate hours showing. Buyers who happen to drive by and see the notice will think it's their lucky day. Make sure everyone who comes to the open house gets a copy of your feature sheet. Plan ahead so you don't book an open house on a long weekend — it will probably be a waste of time. If you're not selling privately, you can rely on your agent to take care of all the organizational details of your open house.

All your neighbours — and your neighbours' friends — may troop through your home. Maybe they're just being nosy, but remember that word of mouth can be a great marketing tool, too. So let them talk. Give them a reason to talk! The more people who know about your fabulous home, the more potential buyers you may attract.

Whatever you do at the open house, observe these three basic rules:

- **Don't negotiate the price verbally.** Be firm that you will seriously consider all written offers.
- **Don't give a particular reason why you are selling your home.** A good standard response is, "We've enjoyed this home, but it's time to move on."
- **Don't indicate you are under time pressure to leave.** This gives potential buyers an edge when negotiating.

Recipe for a Successful Contract

Sale contracts are a bit like pancakes. Basic pancakes need flour, eggs, and milk, but beyond that you can add blueberries, bananas, cinnamon, maple syrup, and anything else you like, whether in the batter itself or on top. There's no set recipe for great pancakes, but some common ingredients do exist. The same goes for real estate sale contracts. The bulk of the recipe will depend on the particulars of your situation. We can't tell you exactly what your recipe should be, so instead we'll tell you what sorts of things are of particular concern to you, the seller, in some key areas. After all, when you cook with quality ingredients you're much more likely to end up satisfied.

A dash of offer

The offer to purchase is prepared by the buyer's agent, and will usually resemble the copy of the Ontario Real Estate Association's contract of purchase and sale. The "Offer to Purchase" section has a threefold function. First, it identifies the parties involved in the transaction:

- You (the seller)
- Your buyer
- The agent(s) acting on behalf of the buyer and seller

If your home is owned jointly by both you and another party (perhaps your spouse or partner), both owners will be identified in the vendor section. Second, the offer will identify the home as it is registered with the local land registry office, the lot and plan numbers, and sometimes the approximate dimensions of the lot. All this information is taken from the listing contract or from the title search that either the buyer, the seller, or their agents have obtained. Last, the offer will set out the major financial details — usually consisting of the offered price and amount of deposit.

Every offer has some common elements. Make sure all this information is supplied in the buyer's written offer:

- The name and address of the buyer (in some provinces, supplied only upon acceptance of the offer)
- The amount of the initial deposit accompanying the offer, or payable on acceptance of the offer
- The civic and legal addresses of the property being sold

- The amount of the buyer's initial offer
- Terms and conditions of the offer
- Completion, possession, and adjustment dates (may be the same day in some provinces or circumstances)
- Time that the offer is open for acceptance (also referred to as "irrevocable time" in some provinces)
- The buyer's signature (witnessed where necessary)

Name and address of buyers

The buyer supplies his name and address, so you know whom you are dealing with (although in some provinces, the buyer's address is obtained only upon acceptance of the offer). If the offer is made in a company name, you'll need to know the position the buyer holds in the company, and whether the buyer has signing authority on behalf of the company.

Be very careful if the buyer's name is followed by "and/or nominee." The buyer may intend to assign the contract to a third party (maybe the daughter who's graduating from medical school in the spring, maybe the money-laundering subsidiary of Crooked Mile Inc.), and ideally the buyer should specify on the contract who that third party (or nominee) is. If the name of the third party is not specified in writing, it may create ambiguity in the contract and possibly make the contract unenforceable. Your agent or lawyer can explain the proper way to assign the contract and deal with any potential problems.

Initial deposit and deposits in general

A deposit is an initial amount of money to confirm the buyer is serious about her offer to purchase your home. A deposit that accompanies your buyer's offer forms part of the down payment when the sale is completed. We recommend the deposit be made by certified cheque or bank draft. Indeed, in some parts of Canada, the deposit must be presented in this fashion.

No standard figure exists for the deposit, but from the seller's perspective, the bigger the better. If the deposit is substantial (a reasonable and substantial deposit is about 5 to 10 percent of the purchase price, depending on the price range), it's less likely your buyer will consider walking away before the sale is completed. If you're buying another house based on the sale of your current home, the deposit gives you assurance your buyer is committed to the purchase of your current home. You do not want to commit to buying a new house unless you feel secure that your buyer's offer is sincere and the sale of your home will be completed on schedule.

Initially, the offer may be presented with a small deposit ($500 or $1,000) that the buyer will increase when all her conditions are removed from the contract. In some provinces no initial deposit applies, only one deposit of about 5 percent. If the buyer doesn't make a sincere effort to satisfy and remove her conditions, thereby collapsing her offer, she risks forfeiting her deposit. So, by making a small deposit, the buyer risks losing less money if she changes her mind about buying your home. If the buyer breaches the contract after conditions have been removed, litigation may follow and it could get messy.

The buyer's deposit can be placed in an interest-bearing trust account, so at least the buyer will earn interest on her money until the completion of the sale.

Civic and legal addresses of the subject property

Your home's address is included to make sure you are selling the right property. While it's not that much of an issue in towns and cities, always check legal descriptions at the land registry office if you're selling vacant land, especially where there may not be a street number and address.

Price of the initial offer

The price is your starting point for negotiations, and probably the first thing you'll want to look at when the offer comes in. If the initial price the buyer offers is at least reasonable, you can probably negotiate an acceptable price for you and the buyer. In an ideal world, the initial offer will be at exactly the price you asked for or better, and you can skip to the part where you negotiate the other terms of your sale contract. If the offer isn't everything you hoped for, see our negotiating tips later in this chapter.

A handful of covenants, a sprinkle of conditions

One of the most important parts of the agreement is the "conditions" of the sale. We know what you're thinking: "Of greater concern than the price?" Yes. The financial details contained in the offer to purchase portion of the sale contract are easily and quickly verified. The conditions of sale may be much more complex and can be treacherous if you don't review them carefully.

In Chapter 3, we discuss the various conditions (or "subject to" clauses) that are common in contracts of purchase and sale. Most subject to clauses require the buyer to do some work to satisfy the subjects, such as the buyer approving an inspection report or obtaining a mortgage. These subjects, or

conditions, are noted in the body of the contract and, in essence, the buyer is saying he will buy your home if it passes an inspection and if the buyer can get his mortgage. There may also be subject to clauses or conditions of the contract that require the seller to do some work. These clauses may require that you remove the junked car in the garage or repair a loose handrail by a specific time, and before the buyer will commit to buy the house.

All terms and conditions included in an offer to purchase your home are negotiable; both parties (you and your buyer) must agree to them. You'll almost never see an offer that doesn't contain any subject to clauses. Sometimes, in a very active market where competing offers are common, the buyer will keep the subject to clauses to a minimum to make the offer as attractive as possible to the seller. Even with a plethora of competing offers, you'll usually find a quick "subject to inspection" clause inserted in the offer. You can choose to reject one or all the subject to clauses the buyer has attached to the offer, but if you do you risk losing the offer altogether. Use good judgment; if you think the buyer's requests are reasonable, then accept them and let the buyer go about fulfilling the conditions. If one or two of them seem completely ridiculous, talk to your agent about making a counteroffer that excludes the conditions you find unacceptable. Of course, if you're selling privately, you have to take care of this yourself, but do consult your lawyer for help so you can state your terms clearly in a counteroffer.

Assuming you do accept a few of the buyer's conditions specified in the subject to clauses of his offer, you must confirm the items have been addressed. In effect, you're saying that, yes, the buyer has arranged his mortgage or approved the inspection report in accordance with subject to clauses in your contract. You and the buyer must acknowledge that these conditions have been met so they can be removed from the offer.

Procedures vary from province to province for removing subject to clauses from an offer. In Nova Scotia, for example, clauses are typically worded so that if no written notice from the buyer to the contrary is received by the seller, the seller can assume the buyer is satisfied. In most provinces, a standard form is attached to the offer stating that X, Y, or Z condition has been satisfied; in Ontario you attach a waiver; in Saskatchewan you attach a condition removal form. In British Columbia, subject to's are removed using a separate amendment. Subject to removal documents are usually prepared by the agents on the applicable standard forms. Standard contracts and add-on forms are suitable for about 99.9 percent of home sales and are mandatory in some provinces. These standard forms are supplied by the real estate agent. If you're not using an agent, you can get these forms from your lawyer.

We go over some of the most common subject to clauses so you have an idea of what your buyer may include in her offer.

Subject to financing

This is the condition the buyer includes in the offer basically as a safeguard until she obtains proper mortgage financing. In some cases the buyer's financing can require that the home be appraised at an equivalent or greater value than the purchase price. With mortgage pre-approval offered by most lenders, many of today's buyers come to the negotiating table with the security of financial backing. Even if they have a pre-approved mortgage, most buyers should make their offer subject to financing for a short period (a couple of days) to allow the lender to do an appraisal and confirm the accepted offer is fair market value. If the buyer does not have a pre-approved mortgage, five to seven business days should be adequate for a bank to arrange a new first mortgage. Like all subject to clauses, the "subject to financing" clause must include a date by which it must be removed. A commonly worded subject to financing clause reads like this:

> *Subject to new first mortgage being made available to the buyer by _____, in the amount of $_____ at an interest rate not to exceed ____% per annum calculated semi-annually, not in advance, with a ____ year amortization period, ____ year term and repayable in blended payments of approximately $_____ per month including principal and interest (plus 1/12 of the annual taxes, if required by the mortgagee). This condition is for the sole benefit of the buyer.*

Subject to financing clauses require buyers to make a true effort to arrange the required financing. They're not permitted to just sit at home and say, "We couldn't get it." If you think a buyer did not make a good-faith effort to get financing, and can prove it, you may be in a position to refuse to return the initial deposit if the offer falls apart because this condition has not been met. This is where lawyers get involved, but keep in mind that a clearly worded subject to financing clause and a true concerted effort by the buyer will eliminate the need for lawyers and disputes related to financing subjects.

Subject to inspection

Most offers these days have a subject to inspection clause, the condition that the home passes a full inspection. No matter how well you have maintained your home, be prepared to have an inspection conducted by the buyer. If you had your home inspected prior to listing, you shouldn't have any surprises with your buyer's inspection. If your home is relatively new and it passed an inspection before you purchased it, and you have not seen any evidence of problems, you probably don't need to worry about an inspection turning up anything significant. If you own an older home in which the major operating systems and structural components have not been updated or replaced in decades, this condition may become an issue. Even if your home seems to be

running smoothly, you may be in for some unpleasant surprises come inspection time. Typically, the clause will read something like this:

> *Subject to the buyer, at their own expense, receiving and being satisfied with an inspection report from a certified building inspector of their choice on or before _____. This condition is for the sole benefit of the buyer.*

The main reason against having a pre-listing inspection is that, should it reveal any problems, you're legally obligated to disclose that information. Disclose everything in writing to avoid future problems.

Subject to sale

Buyers often make an offer conditional on the sale of their previous home prior to an agreed-on date. Perhaps your buyer doesn't expect to have any problems selling his home, but is simply playing it safe. But perhaps he's in a position to make only a conditional offer because he thinks he'll encounter difficulties in unloading his own property, and he has to sell his home to be able to buy your house. We discuss in Chapter 4 why buying before you sell is dangerous. It's your call whether to accept an offer with this sort of condition. If you're confident in your buyer's ability to sell his previous home, or if you feel you're not in a position to be rejecting reasonably priced offers (conditional or otherwise), then accepting may be the best course. But if you're in a seller's dream market (for example, downtown Toronto) and you have no doubt that another, unconditional offer will be forthcoming, you may wish to hold out for the better offer. Talk to your agent about market conditions in your area and how they should influence your perception of a "good" offer. The sale clause could be written as follows:

> *Subject to the buyer entering into an unconditional agreement to sell the buyer's property at 123 Main Street, Anywhere, Saskatchewan, by _____. This condition is for the sole benefit of the buyer.*
>
> *However, the seller may, upon receipt of another acceptable offer, deliver a written notice to the buyer or the buyer's agent [enter name of the buyer's agent and company name] requiring the buyer to remove all conditions from the contract within 12/24/48/72 hours [choose one] of the delivery of the notice. Should the buyer fail to remove all conditions before the expiry of the notice period, the contract will terminate, and all deposit monies will be returned in accordance with the Real Estate Act.*

The portion of this clause from "However" on is known as the time clause. This clause is extremely important if you think you may receive other offers while this buyer is trying to sell his home. The length of the notice period is negotiable and can be as short as 12 hours, but this puts a lot of pressure on

the buyer, and you will find that many buyers won't agree to this. If you are in a seller's market, you'll want to keep the notice period as short as possible, because this will allow you to deal with a backup offer relatively quickly if one comes in. From the buyer's point of view, the longer the notice period the longer he'll have to arrange interim or bridge financing. And the longer he'll have to consider all his options, and the longer he'll have to sell his house.

If you need to invoke the time clause, you may want to get confirmation that the notice was actually delivered at a certain time. Although technically this is not necessary to make the notice valid and enforceable, it helps keep everyone clear on the process. The delivery can be witnessed by someone, or the buyer or the buyer's agent can sign a copy of the notice to acknowledge they have received it. At this point, no negotiating occurs and you are just waiting to see who will buy your home. The notice to invoke the time clause will look like this:

> *This notice constitutes written notice from the seller to the buyer requiring the removal of all conditions (or condition) from this contract within (24/48/72) hours or this contract will terminate at the end of the (24/48/72) hour period and the deposit will be returned to the buyer. This time clause will start running on delivery of this notice to the buyer or [the buyer's real estate agency] which will be at _____ o'clock a.m./p.m. on (date), 2008. Therefore, the [24/48/72] hours will terminate at _____ o'clock a.m./p.m. on [date], 2008.*

In some provinces, you may have to exclude Sundays and statutory holidays from the time clause. In this case, the clause will read "24/48/72 hours excluding Sundays and statutory holidays." Your agent or lawyer will know local provincial regulations.

Escape clauses

Another category of subject to clauses depends on a third party or requires the approval of one party to the contract. These third-party subject clauses are often called escape clauses or whim and fancy clauses, because either party can simply withhold approval and walk away from the contract.

One of the most obvious escape clauses is *subject to a relative or friend reviewing the contract.* This is very ambiguous and hard to enforce, and we recommend you do everything you can to avoid such a condition. Another escape clause would be *subject to the buyer obtaining financial advice.* The buyer should have received financial advice before writing the contract — this is an extremely obvious escape hatch.

You or your agent should recognize escape clauses and try to eliminate them or keep them to a minimum, and where they are necessary keep the time

frame as short as possible. Generally, a contract with an escape clause is unenforceable until the subject is removed.

Clauses introduced by the seller

Few vendors are concerned with what happens to the property after it has been sold. However, in some cases the vendor may like to place restrictions or obligations on the new owners of the property. For example, when history buffs and activists Pierre and Marie decided to sell their Vieux Quebec home, which had narrowly missed being designated a Canadian heritage site, they wanted to stipulate in the contract of purchase and sale that the new owners respect the home's historical significance. So they introduced a clause stating that the new owners were forbidden to undertake any major additions or renovations to the original structure other than restorative projects to preserve the character and historical importance of the building. However, most covenants of this sort come with the land and are not the prerogative of the seller to introduce.

If your property has municipal or provincial conditions restricting the use of the property, they should be clearly outlined in the contract to protect you from any future actions by the buyer. If you're not in an unusual position like the one mentioned above, and there were no restrictions or obligations placed on you when you bought the property, don't attempt to introduce these sorts of clauses.

Subject to seller's purchase

Another clause that you as a seller may need to include is a subject to purchase clause. This condition stipulates that the buyer's offer to purchase will be accepted only if the seller's offer to purchase another home is in turn accepted. Such a clause would be written into the contract of purchase and sale as follows:

> *Subject to the seller entering into an unconditional agreement to purchase the property at _____ by _____. This condition is for the sole benefit of the seller.*

Subject to purchase clauses are not very common, so it's always a good idea to let the buyer know the seller's plans in advance so the buyer won't be surprised to see a seller's condition added to the contract.

What's included — Fixtures and chattels

Anything that is fixed to the structure of your home (known as a fixture) is assumed to be included in the purchase price unless otherwise stated. Anything movable — appliances, furniture, and the like, known as chattels — is assumed to be excluded from the sale. Nonetheless, in some provinces

appliances are typically included in the sale price. Find out early in the process what the conventions are for your area. Now is the time to exclude from the sale anything the buyer might think she will be getting, whether it's your fabulous new and astonishingly silent dishwasher, or the antique chandelier from your great-grandmother.

The contract of purchase and sale will list exactly what is, and what is not, included in the sale. How would you like to buy a home in Moose Jaw, and take possession in February only to discover the furnace had been ripped out of the basement? These kinds of events are not common, but they have been known to happen. Clearly this section of the contract is of greater importance to the purchaser — the one likely to get the short end of the stick. But you need to do a quick review of this section as well, just to ensure everything you want to take with you will be yours come moving day.

Time frame of the offer

The time frame of the offer is one of the most important elements of your contract of purchase and sale. This element states that the offer is valid only for a certain length of time. If this length of time expires before the offer is accepted, the offer is null and void and the deposit is returned to the purchaser unless both parties agree to extend the time for acceptance.

The completion date is the date on which the buyer pays her money and has the house registered in her names. The possession date is the date the buyer assumes possession of the property. If all conditions have not been met by the subject removal date, the offer can be withdrawn and the transaction terminated.

Pay extremely close attention to these dates. Most contracts hold the vendor responsible for the property until the completion date. If a fire ravages your home the day before the completion date, it's your problem. From 12:01 a.m. on the completion date, the property and all included items will be at the risk of the buyer. The buyer will actually have insurance on the house hours before the house is registered in his name.

Arrange to have your insurance policies terminated on the closing date and not before. If possible, avoid the last day of a month or year as a closing date. These are busy days for banks, creditors, insurance providers, and most administrative staff that will be involved in processing the new information generated by the sale. This means you are at an increased risk of otherwise avoidable delays in registering the sale of your home.

If you have rental units

The contract of purchase and sale becomes considerably more complex if your home has rental units and your buyer intends to continue renting out

these parts of your property. This aspect is typically a larger headache for the buyer than for the seller. However, if you have tenants at the time of sale, be prepared for some extra hassle. For example, if you live in Ontario, you will have to sign a statement to the effect that you are charging a legal rent. If it turns out you are not charging a legal rent, you're in trouble not only with your tenants, but also with your buyer. The possible obstacles are far too case-specific for us to deal with here — so all we can do is give you some general advice.

If you have a rental unit and are selling to a buyer who intends to continue the tradition, speak to your agent or lawyer about the legal and contractual consequences before signing the contract of purchase and sale. If you are getting close to an agreement on price and you want to keep negotiating, you can go ahead and accept the offer, but make it subject to consulting with your lawyer if you have concerns. In many parts of the country, a copy of the rental agreement may become an addendum or schedule to the contract. If the buyer wants to terminate the tenancy, the buyer will request in the contract that the seller give legal and binding termination notice to the tenants in accordance with the provincial tenancy legislation.

A pinch of acceptance

This final section of the contract is quite simple. When the contract has been negotiated to your and the buyer's satisfaction, all that remains is to sign on the dotted line (as well as filling in the appropriate dates and seals), and accept the offer subject to the terms and conditions outlined. Make sure both parties have initialled any changes to the contract and that all signatures have been witnessed where necessary.

Controlling the Negotiating Process

In reality, the first step you'll take as a seller in the negotiating process is setting the asking price for your home. Whether or not you're using a real estate agent, your asking price lays the groundwork for the selling process. It can affect how many offers you receive, and is the springboard from which you'll dive into the deep and murky waters of conditions, terms, and clauses.

Don't negotiate until you get a written offer. And don't sign anything until you've consulted with your real estate agent or your real estate lawyer (or notary public, if you live in Quebec). You need a professional to make sure the contract is legally binding and the terms and conditions represent you

properly. This is tricky stuff. If you have even a signature in the wrong spot, the contract may be null and void.

Don't dismiss early offers. Houses often generate the best offers earliest in the process when they're fresh on the market . . . and you never know when, or if, the next serious offer will come. Remember that an offer represents an opening bid to start negotiations. Both the buyer and the seller want the same thing: the best possible price and terms of sale. Each party can make certain concessions and certain gains.

The offer may seem to be overly detailed and specific, but to ensure you have a binding contract with no misunderstandings, every detail should be written into your purchase agreement. It may seem silly to include little things like remote garage door openers in the contract, but it's those little things that can drive you crazy if they're not clearly specified in writing.

When you get an offer, your options are to accept it, reject it, or "sign it back" — that is, return it to the buyer with a counteroffer proposing a different price or different terms. Review the offer with respect to each of the following considerations.

How low will you go?

First and foremost, we're all interested in the prices we pay for our purchases. Your home is not just a purchase, though; it's an investment — and if you've cared well for your home, chances are you'll be able to make a profit when it comes time to sell the place. Determining what your home is worth in the current housing market takes a bit of analysis. But when you've figured out your listing price, you also need to decide what is the lowest offer you'll accept.

The initial offer is the buyer's starting point, just as the list price is your initial bargaining position.

Entertain any and every offer you receive. Don't reject anything out of hand, unless your lawyer or real estate agent strongly advises you to do so; make a few changes to the agreement and counter your buyer's offered price. If a buyer is interested enough to write up the paperwork, you have a better-than-decent chance of negotiating a price you're willing to accept.

Negotiating requires give and take. If you don't give the buyer an idea of your flexibility, he won't take the time or effort to pursue an agreement. A buyer may be truly interested in getting your home, but put in an offer that cuts $25,000 off the asking price. Don't tear it up; he may be following the "you

can't blame a guy for trying" philosophy. The response to your counteroffer may surprise you by being, "Yeah, okay."

"Only if you promise to . . .": Negotiating the "subject to" clauses

Subject to clauses are a buyer's safety-hatch — a way to escape the contract of purchase and sale if something goes wrong. If a buyer needs to sell his home before he can afford to buy yours, he may make his offer "subject to sale" (meaning that his offer to buy your home will be confirmed only when he's been able to secure the sale of his own current residence). (Refer to "A handful of covenants, a sprinkle of conditions" for details.) Three of the most common clauses on an offer to purchase are subject to financing, subject to inspection, and subject to sale.

- **Subject to financing clauses** don't offer much room for negotiation. A buyer can't remove this subject clause during the offer/counteroffer process, unless perhaps she has a lot of equity and doesn't really need a mortgage, or requires a small and easy-to-get fast mortgage. Remember, if the buyer didn't need a mortgage, she likely wouldn't have made the offer subject to financing in the first place. You can try to negotiate a shorter time limit for the buyer to arrange her mortgage, however. Often, too, a buyer will have a pre-approved mortgage — it's usually only a matter of an appraisal to have the mortgage finalized. If this is the case, then allowing the buyer this clause may put you in a better position to negotiate other things.
- **Subject to inspection clauses** are commonly included in a buyer's offer to purchase a home. It should take no more than two or three days to arrange an inspection, so this is an easy clause to negotiate. As with the subject to financing clause, though, you can try to negotiate a shorter time period for the inspection's completion to speed things up. Most inspectors can deliver a copy of the inspection report at the end of the inspection.
- **Subject to sale clauses** can be negotiated with regard to the length of time you give your buyer to sell his current home. Any buyer who already owns a home probably can't afford to carry the expense of two homes at once. You have to be reasonable here. No matter how anxious you are to move, allow the buyer a decent amount of time to list and sell his home. Usually four to six weeks is considered fair, and (depending on how badly you want to sell to this particular buyer) you can agree to extend the time period if he can't meet the original deadline.

In conjunction with the subject to sale clause, also include a time clause to keep your options open. If you're waiting for your buyer to secure financing or sell her residence, your time clause can release you to pursue another offer that arrives in the meantime.

The time clause gives the first buyer a specified time period to remove all the subject to conditions from the contract and close the sale. If the first buyer can't remove all the subjects in time, your time clause releases you from the contract and allows you to pursue other offers.

If you extend the subject to sale clause, you'll probably have to extend the completion and possession dates stated on the contract of purchase and sale. Whatever dates you choose will probably change when your buyer has a buyer for his own home. Your closing date for the sale may depend on your buyer's yet-to-be-negotiated closing dates on the sale of his home.

If you've found a home you really want to purchase after selling your own, you can try to add a subject to purchase clause that makes your home's sale conditional on whether you can still get the house you want. But be prepared: Your buyer may not be happy with this condition and may not accept its inclusion in the contract. These clauses are not at all common, but in some situations they can give you peace of mind that you won't be homeless if your dream home was snatched up before you had a chance to sell.

If you're selling a condominium, you may encounter a subject to viewing condominium bylaws and financial statements clause. In many provinces, the law requires that a condominium corporation provide the buyer with full information on the condo complex and its regulations. Your buyer must acknowledge in writing that the information's been received and approved — not too many negotiating points here, except for the time frame and how far back into the building's history the buyer would like to go.

Expect some regional differences and extra information to be required in different parts of the country. For example, around Vancouver (home to a number of leaky condominiums), the buyer may ask for any engineering reports or building envelope studies that are available, and the seller must provide the information to the buyer.

In most provinces, after a subject to condition in the contract of purchase and sale has been met, it's formally removed from the contract with a written waiver, amendment, or condition removal form. These legal documents are usually signed by both parties (the buyer and the seller) to confirm that a condition has been fulfilled and is no longer part of the offer.

"I never liked those drapes anyway": Including appliances and household decor

Anything permanently attached to the property is considered to be part of the package. So any built-in cabinets, built-in appliances, or wall decorations — legally considered fixtures — are things you'll be leaving behind for the next owners. Anything portable (chattels), on the other hand, is yours to keep, if you want it. Under this logic, the drapes are still yours, but the tracks they hang from aren't; Grandma Bertha's bedside lamp comes with you to your new home, but the beautiful chandelier in the entrance hall belongs to the new owners.

Anything portable that you do want to leave behind (the drapes, the refrigerator, the pool-cleaning accessories you won't need in your new condo) must be written into the contract specifically and listed item by item. Something else to keep in mind, though: Anything you don't want to leave behind is best removed before showing the house at all. If you can't do that, be sure to make it clear to everyone who walks through the door that those items are not part of the deal. You don't want prospective buyers to fall in love with an antique light fixture that you would never consider parting with, and make an offer that turns on whether or not it's included in the sale. And build everything (exceptions and inclusions) into the property section of the contract. If you include a built-in vacuum system, make sure you also include the attachments and powerhead for the system.

Even if you plan to include portable items in the sale of your home, do it at the last minute. If the portable items are listed in the contract right from the start, they don't seem like bonuses when you're negotiating because potential buyers will try to talk down your price anyway. If you wait until after the buyer tries to talk you down, "throwing in the drapes" or including the washer and dryer may appease him as much as lowering the price.

Don't include any leased items as part of the sale. Many companies lease security systems and water filtration systems, and if they're left with the house, the buyer will be charged. The last thing the buyer wants is to get a bill for a security system she thought she'd bought outright with the house. Specify in writing that the buyer agrees to assume the lease on the security system if a lease applies.

Buyers might also specify that certain items be removed as a condition of the offer. Some people just don't want the brown and gold linoleum and faux-wood panelling greeting them on moving day. Some buyers make big requests.

For example, you might receive an offer $5,000 below your asking price and with the condition that you remove the shag carpeting. Part of your negotiations will include figuring out the buyer's priorities. Is he just looking for any excuse to cut the price? Is he willing to budge on the rug? As a concession, you might agree to remove the rug but cut less off the price. Or you could try dropping your price and leaving the rug with the property. Your agent or lawyer won't recommend any substantial changes to your home before closing — just in case your home doesn't close for some reason — but, hey, when your buyer insists that if you remove all the tacky light fixtures he will agree to the price in your counteroffer, you can probably agree to remove those lights.

The closing date

After having spent a couple of hours reviewing the price, the subjects, and all the inclusions and exclusions, the dates may seem relatively minor. Give yourself a breather from the contract and then refocus. The dates will be the most important factor when moving time comes around. If you can negotiate a sensible and relaxed set of dates now, your move will be much easier at a time when stress will be at an all-time high. Again, if you can get ideal dates scheduled, you may drop a little bit off the price in return for the buyer's flexibility.

The closing date (or completion date) is the day when the money changes hands and the title is conveyed to the buyer. The possession date is the day you give (or receive) the keys to (or from) the other party. The adjustment date is the day that property taxes, condominium fees, and any other annual municipal fees and utility bills are adjusted to. These last two dates should be one and the same: you get the keys, you start paying the bills.

Ideally, give yourself a one- or two-day overlap where you have the keys for your new home as well as the keys for the house you've sold. The following would be a perfect scenario, starting on a hypothetical Monday:

- **Monday:** Completion date on your present home.
- **Tuesday:** Completion date on the home you're buying.
- **Wednesday:** This is the adjustment date for the home you're buying. You get the keys for the house you're buying at noon (usual time of key transfer) unless you negotiated an earlier time.
- **Thursday:** This is the adjustment date for the buyer of your home. You give the keys to the buyer of your old home at noon.

This scenario gives you a chance to have a relaxing move, and still go back to clean up your old house Thursday morning before you give the keys to the

buyer of your old home. The downside is that the buyer pays their money on Monday but doesn't get her keys until Thursday noon. This is fairly common in some provinces, and for the right price, the buyer will accept the dates when she has negotiated with you on all the terms of the agreement. In other provinces, such as Ontario, it's common to have the closing date and the possession date as the same day. If this is the case, it may be worth arranging interim/bridge financing to close the house you are buying a couple of days before your present home's closing date so you don't have to store all your possessions, especially if something is delayed.

Discuss with your real estate agent or your lawyer how many days you'll need for the closing. If you're working with a real estate agent, you may still want one or two days to run the contract by a lawyer. In some provinces, legal documents can't be signed on Sundays or statutory holidays.

The transfer of title officially closes the contract when you file the paperwork at the land registry office. These offices are typically open from 9:00 a.m. to 3:00 p.m. weekdays. No matter how pressed for time you are, don't even try to officially close two contracts on the same day. Leave at least one day to close the sale of your current home and transfer money before you go back down to the land registry office and close the purchase of your next home.

Mulling Over Multiple Offers

If you're lucky enough to be selling your home in a red-hot seller's market, you may get competing offers on your home. This embarrassment of riches has to be treated carefully to ensure you get the offer you want in place without selling the house to two different people.

Keep these guidelines and practices in mind to ensure everything goes smoothly:

- **Keep everyone informed.** If more than one group is interested in your home, it's in your best interest to make sure everyone is kept up to date when offers are starting to be written. In the ideal scenario for the seller, the buyers enter into a bidding contest and pay up to, or over, the asking price.
- **Act in good faith.** Many buyers will not compete with another group when making an offer. Remember that what's good for the seller is not always good for the buyer. If a seller tries to get cute and delay one offer hoping to get a second competitive offer, both potential buyers may cancel their offers.

Imagine Ken and Sue have listed their fabulous heritage house for sale. It's a hot seller's market, meaning buyers outnumber sellers, and the low inventory of homes means Ken and Sue should get close to their $499,000 asking price.

Buyers A, B, and C all see the house the first day it's listed for sale, and all come to the same conclusion: The house is gorgeous, the house is well priced, and they want it.

Ken, Sue, and their agent get together to review the offers. Buyers A were the first to notify the listing agent that they had an offer, so their offer is presented first, followed by the offers from B and C. Before making changes to any offer, Ken and Sue discuss all three offers with their agent and decide which offer has the most potential. Buyer C offered $475,000, which was all he could afford. Both A and B offered the full price of $499,000 with similar terms and conditions.

Ken and Sue decide to deal with offers A and B. A's offer is $499,000 and subject only to inspection. The dates are perfect and the $50,000 deposit is attractive. B's offer is $499,000, but it's subject to financing (with B stretching to afford the price) and inspection, with a $25,000 deposit.

Ken and Sue have a couple of options: They can choose to accept one offer as is, or with minor changes that both parties agree to, and hope the conditions go through and the contract is fulfilled. Or, they can reject both offers as presented and ask A and B to present better offers and hope for an even more advantageous offer. In the end, Ken and Sue decide to accept A's offer. But they actually have a third option: accept B's offer as a backup offer.

Considering Backup Offers

In some provinces, a second offer can be accepted as a backup offer, subject to the collapse of the first offer. Your agent or lawyer will advise you what is acceptable in your province. The offer would be worded something like:

> *This is a backup offer only and is subject to the seller being released by the buyer from all obligations under the previously accepted Contract of Purchase and Sale by _____, 2008. This condition is for the benefit of the seller.*

Looking again at Ken and Sue's situation from "Mulling Over Multiple Offers," the couple could accept B's offer as a backup offer subject to A's offer collapsing. B has nothing to lose by being a backup offer for a couple of days while A has an inspection done. Should A not be thrilled by the inspection,

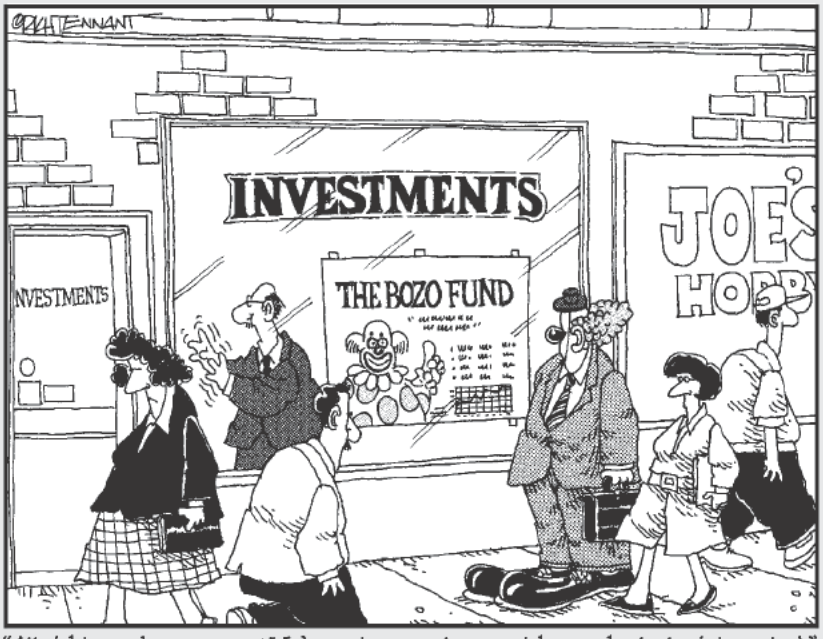
then B would have the chance to purchase the house, subject to B's own inspection and financing. If A buys the house, then B's offer would not proceed and B's deposit money would be returned.

The other common situation for a backup offer occurs when the buyer has added a subject to sale clause to the offer and a second offer comes in, subject to the collapse of the first offer. In this scenario, the first offer should have a time clause in it, giving the buyer 24, 48, or 72 hours (or whatever was negotiated) to remove all subjects from the contract. When the sellers have a second acceptable offer, the sellers give written notice to the first offer to remove all subjects within the prescribed time frame, or step aside so that the backup offer will be the offer in effect. An example invoking the time clause can be found in the "Subject to sale" section in this chapter.

In the best of both worlds, the seller wants to sell at her listing price and the buyer wants to buy at his originally offered price. Negotiating is what falls in between.

Book IV
Investment Fundamentals

The 5th Wave By Rich Tennant



"All right, ready everyone! We've got some clown out here who looks interested."

Contents at a Glance

Chapter 1: Setting Realistic Goals and Expectations 291

Chapter 2: Your Savings Choices: Savings Accounts, Tiered Accounts, and GICs 299

Chapter 3: Stocks, Bonds, Mutual Funds, and Real Estate 305

Chapter 4: Monitoring Your Progress 327

Chapter 5: Becoming an Effective Investor 337

Chapter 1

Setting Realistic Goals and Expectations

In This Chapter

- Understanding risk and reward
- Understanding the importance of compound returns
- Writing down your goals
- Determining how much you need to invest to reach your goals

In this chapter, you can focus on the starting points of thoughtful investing. You can also find out why you need to determine your goals and get started on your investment plan as early as possible.

Understanding Risk and Reward

What draws you to investing? Maybe it's the hope the robust stock market of the type we saw in the late 1990s and again in the mid-2000s will return. Or maybe you're enticed by the idea you can put your money to work for you by investing it. Most people are drawn to investing because they have a salary or money in the bank — or both. If you have an income or capital, then tax and inflation will slowly eat away at your money. The goal of most investment strategies is to protect your income and capital from tax and inflation.

Although the benefits of investing are made clear in success story after success story in advertisements, magazines, newspapers, and Web sites devoted to investing, remember there's no gain without potential pain. When you invest your money, you can lose part — or all — of it.

Actually, rewards and risks are usually closely related. The greater an investment's potential for reward, the greater the potential for risk and actual loss.

The high-flying stock that earned a 100-percent return last month is probably the very same stock that will tumble (and tumble hard) in the months and years ahead. Although stocks can tumble so hard they might become completely worthless, the same cannot be said for bonds, mutual funds, and real estate. However, you can still lose money if you invest unwisely in bonds, mutual funds, and real estate.

You must take on some risk in order to reap the benefits of investing. That's the bad news. The good news is that most often, over time, a decent investment will bounce back and make investors whole again.

What's the best you can hope for?

The best you can hope to achieve with an investment depends on the nature of the investment. Some investments — such as savings accounts and guaranteed investment certificates (GICs) — offer stable, secure returns. Other investments — such as stocks, bonds, and mutual funds — depend entirely on market conditions. A *return* is an investment's performance over time. It's easy to calculate the best-case scenario with vehicles such as savings accounts, Canada Savings Bonds (CSBs), and GICs. On the other hand, you can never predict with total accuracy what kind of return you will get with more volatile investments such as stocks, mutual funds, real estate, and corporate bonds.

You can, however, see how these investments have performed in the past. Recent history has many investors believing the markets can only go up. If you look at returns on some stock investments, you can understand why.

For example, from the mid-2000s up to very recently, the top-performing stocks on the Toronto Stock Exchange (TSX) (which became TMX in 2008) were prevalent in the petroleum, mining, and real estate sectors. Annual returns of up to, if not more than, 50 percent were common for strong companies in any of these sectors. Their growth was driven by the growing international need for fuel and resources, especially in emerging countries like China and India. The recent real estate boom in North America also caused several real estate stocks to go up in value by enormous leaps and bounds, although things have cooled a bit in this sector since then.

When evaluating what you can expect from investments such as stocks, bonds, and mutual funds, a broad historical perspective is helpful. Long-term government bonds have fluctuated considerably since the 1950s, when total returns were as low as 2 percent and 3 percent annually. In the 1980s, those total returns skyrocketed. But, overall, the average annual return for long-term government bonds from 1950 to the present is a more conservative 6.4 percent.

Treasury bills, which are short-term government debt issues (more on T-bills in Chapter 3), returned about 6.4 percent average in the same period, while corporate bonds were slightly better at about 7.8 percent. Equities (stocks) have yielded the highest average annual return — about 12 percent — but have also tended to be more volatile. For investors who can't tolerate the risk of losing their initial principal (something that's possible even with some corporate bonds), safer investments with lower returns might ultimately be the better choice.

What's the worst-case scenario?

You've heard about the best you can hope for, now what about the worst? One of the worst performers on the TMX over the last three years cost investors a frightening 80 percent. In other words, $1,000 would have been worth just $200 by the end of the year.

You can lose all of your money if a company you invest in declares bankruptcy.

What's a realistic course?

The good news is that if you or your adviser chooses your investments carefully — and subsequent chapters of this book give you the tools to do this — you should be able to minimize your losses. Ideally, your losses from any one investment may even be offset by the successes of your other investments. That's called diversification.

Of course, if you're completely uncomfortable with the prospect of losing money, or if you need your money within two years, then investment vehicles such as stocks and corporate junk bonds aren't for you. You're better off putting your money into safer, more liquid places such as bank accounts and guaranteed investments, which we discuss in Chapter 2, or in a money market mutual fund, which Chapter 3 examines.

Realizing Gains through Compounding

Starting out as a first-time investor doesn't require a whole lot of money, which means you don't need to wait until you've accumulated a large reserve of ready cash. You may ask: Why the big rush to start investing?

The answer is simple: You want to begin earning compound returns as soon as you can. Compounding is actually the return you earn on your return. For example, if you invested $10,000 and earned 10 percent in the next year, your income would be $1,000. If you earned 10 percent again the following year, the $100 you earned on the $1,000 (the return you earned in the current year) would be considered compounding.

Compounding is a compelling reason to start and keep investing for the long term, because money left untouched reaps the greatest reward from compounding.

Table 1-1 shows the power of compounding and how quickly $100 invested each month can grow under different return scenarios.

Table 1-1 The Beauty of Compounding

% Return	*5 years*	*10 years*	*15 years*	*20 years*	*30 years*
	$6,000	$12,000	$18,000	$24,000	$36,000
5%	$6,829	$15,592	$26,840	$41,275	$83,573
8%	$7,397	$18,417	$34,835	$59,295	$150,030
10%	$7,808	$20,655	$41,792	$76,570	$227,933
12%	$8,247	$23,334	$50,458	$99,915	$352,992

To calculate how many years it will take to double your money as a result of compounding, use the *Rule of 72*. Just follow these steps:

1. **Determine what rate of return or growth you think your money will earn.**
2. **Divide 72 by that rate.** The number you get is the number of years it will take to double your money.

For example, suppose you believe you'll earn 8 percent annually in the coming years. If you divide 72 by 8, you can see that doubling your money will take nine years.

"Growth" or "return" can come from many sources. The easiest to understand is the interest earned from your savings account or a GIC. Growth can also come from the value of a stock or mutual fund going up. If a company pays you a dividend, that's also growth to your investments.

Focusing on a Goal

You can take the first step toward creating your investment plan by asking yourself a simple question: What do I want to accomplish? Actually, this step is your single most important move toward ensuring that your investment plan has a sound foundation. After all, these goals are the reason you're launching a personal investment plan. So don't shirk this exercise. Dream away.

Perhaps you've always wanted to travel around the world or build a beachfront chalet. Or maybe you're interested in going back to school or starting your own business. Write down your goals. Your list of goals can serve as a constant reminder that you're on the course to success.

Don't forget the necessities, either. If you have kids who plan to go to college or university, you need to start preparing for that expenditure now. Your retirement plans fall into this category as well — now is the time to start planning for it.

Table 1-2 gives you a convenient format for writing down your goals. As you fill in Table 1-2, separate your goals into long-, mid-, and short-term time frames based on when you expect or need to achieve the goal. For example:

- Buying a vacation home or retiring 10 or more years from now is a long-term goal.
- Sending your child to college or university in 5 to 10 years is a mid-term goal.
- Buying a car in the next 1 to 4 years because you know your current model is likely to be on its last legs is a short-term goal.

As you jot down your goals, also write down their costs. Use your best "guesstimate"; or, if you're not sure, search the newspaper for, say, the cost of a beachfront home that approximates the one you want to purchase. Leave the "Time and Monthly Investment" column alone for now — that column represents the next step, which you find out more about shortly.

Table 1-2 My Goals

Time Frame	*Cost*	*Time and Monthly Investment*
Short-term:		
Mid-term:		
Long-term:		

Okay, now for the tricky part. How much do you need to invest each month, and over what period of time, to achieve your goals?

Of course, you need to know an approximate rate of return before you can plan. Your rate of return will differ depending on the sort of investment you choose. Research can help you accurately estimate your rate of return. (Chapters 2, 3, and 4 tell you how to go about getting this information for different types of investments.)

As an example, Table 1-3 shows you what you need to invest each month to earn $100,000 over different periods of time. Need $10,000 instead? Divide the monthly investment amount shown in Table 1-3 by 10. Want to save a million dollars? Simply multiply the amount by 10.

Table 1-3 Monthly Investments to Earn $100,000 at Varying Rates of Return or Growth Rates

Years	*5%*	*8%*	*10%*
5	$1,480	$1,350	$1,280
10	$640	$540	$480
15	$370	$290	$240
20	$240	$170	$130

If you're older, in retirement, or just plain more conservative (and like to keep a good bit of your money in accounts or investments that earn less return), you may want to use a lower estimated interest rate in your calculations to reflect your situation.

If you're investing in another type of asset — real estate, for example — a local real estate agent can tell you the appreciation rate or the annual rate of return for properties in your area. You can use that rate as a gauge to estimate what you might hope to earn in future years.

Use a scientific calculator to determine how much you need to sock away annually to meet your goals over a specific period of time.

Starting Your Savings Now

Throughout the rest of this book, you find out about different types of investments that match your investment goals. To start out with any sort of

investment, you need a cash reserve — and the amount varies depending on your investment choice.

As you're doing your research and deciding which investments match your goals, start putting away $100 a month in an account earmarked for investment. By the time you determine the investing opportunities that best fit your needs, you should be well on your way to affording your investment.

Watching your dollars multiply can serve as motivation in itself: Your investments may become as or more important to you than some of the other expenses that have eaten up your money in the past.

If you're the type who's been saving gobs of cash in a bureau drawer for a long time and now want to start earning real return or growth, you're one step ahead of the pack. You have the discipline. Now what you need is the knowledge and the tools.

The following chapters give you the tools you need to select investments and create an investment plan to meet all your goals, including retirement. You also get the information you need to monitor your investments, so you can keep your plan on track.

Chapter 2

Your Savings Choices: Savings Accounts, Tiered Accounts, and GICs

In This Chapter

- Sticking with the tried-and-true: Savings accounts
- Tacking on more interest with tiered accounts
- Discovering GICs

You can choose to be either a financial hare or a financial tortoise. As a financial hare you can race ahead, spending everything you earn now and having nothing later. Or, as a financial tortoise, you can pace yourself and spend responsibly, knowing that by spending a little less today you can spend a lot more tomorrow. Assuming you choose to be a financial tortoise, slowly and steadily socking away savings, where are you going to put those first dollars you've set aside?

This chapter is about making savings choices that are appropriate for money you don't want to put at great risk — for example, money you have earmarked for emergency funds, or money you're saving to buy a car, furniture, or a home within the next few years. By keeping your short-term money somewhere safe and convenient, you can feel comfortable putting your long-term money at somewhat greater risk. (Chapters 3 and 4 tell you about these kinds of riskier investments.)

Although they may not be the most exciting investments you'll ever make, savings accounts, tiered accounts, and guaranteed investment certificates (GICs) or term deposits are worthwhile considerations for novice investors. Everyone should have some money in stable, safe investment vehicles. Savings accounts, tiered accounts, and GICs are basic savings tools and are the first step on your path to investing. These tools can help you build up the money you need in order to start investing in other ways.

As you get to know investment vehicles through this book, you find out which ones are good for short-term investments and which are best for the long haul. How you invest your money depends largely on two factors: how long the money can remain out of your reach (time); and how much of it you can afford to lose (risk). Some investments are a lot riskier than others.

In this chapter, you find out about the safest investments for short-term money you can't afford to lose, as well as what you need to know before you throw your hard-earned dollars into the pot.

Starting with Savings Accounts

Savings accounts are a form of investment — a very safe form. Although many banks don't pay interest on traditional chequing accounts, they almost always pay interest on traditional savings accounts. Most banks will offer a variety of accounts — some that combine an interest-bearing savings account with limited cheque-writing privileges.

For the most part, interest rates offered for traditional savings accounts differ only slightly from institution to institution. Don't expect too much, because the rates are not very high. Today, the average savings account in Canada hovers at about 2.5 percent. Some accounts pay more if you have more cash in the account. With this kind of return, it's no surprise more and more Canadians are choosing to sock money into slightly higher-yielding investments like money market mutual funds. (More on these in Chapter 3.)

When you further tack on inflation — even the very low rates seen in the past few years — that eats into your money over time, you might be asking yourself why you'd invest in a savings account at all. When taxation comes into the picture on top of inflation, it might be two steps forward and three steps backward for the return you enjoy on savings accounts.

Actually, you might want to invest in a savings account for several reasons. First, if you are a truly novice investor, a savings account can be the beginning of your learning process. You'll gain confidence when shopping around for the best possible interest rate, and again when you deal with the financial institution directly while opening the account.

Second, and more importantly, the money you invest in a savings account comes with an ironclad guarantee. Why? If the bank or trust company has Canadian Deposit Insurance Corporation (CDIC) insurance, your savings account is backed by the full strength and credit of the federal government. If the institution fails, the feds see that you automatically get your savings back — up to $100,000 per person, per institution, subject to some restrictions. As with any other insurance, you may sleep better knowing that CDIC is there in the worst-case scenario. Credit unions have similar deposit insurance.

Although putting your money in a savings account has serious limitations if it's your one and only investment strategy, having some of your money in a cash reserve makes sense. But as investments go, you wouldn't want to rely wholeheartedly on a savings account because the return on your investment is so low. Of course, factors such as fluctuating interest rates, income tax rates, and the inflation rate play a major role in how well your money does in this type of investment vehicle.

Web sites such as Canoe Money (`money.canoe.ca/rates`) publish lists of savings account interest rates at major Canadian financial institutions including banks, credit unions, and trusts.

Most banks charge a monthly or quarterly maintenance fee for a savings account. Some tack on an additional fee if your balance falls below a required minimum. In addition, you might be required to keep a savings account active for a specified time or face penalties, politely known as service charges.

Stacking Up Tiered Accounts

Some banks offer savings accounts with the added incentive of earning additional interest if your account balance remains consistently above a specified amount. This amount is usually at least $1,000, but it may be as high as $60,000 or even higher for some savings accounts.

These types of accounts are often referred to as *tiered,* or as using deposit interest tiers. For example, with Scotiabank's "Scotia Gain Plan," interest rates are tiered and are up to 1 percent above the regular savings account rate. But daily balances below stated amounts (minimum $5,000) will be paid at the regular rate. At Royal Bank, the "RBC Enhanced Savings" account pays about 0.50 percent interest on an account balance between $5,000 and $25,000. If you have between $25,000 and $60,000, that rate goes up to about 2 percent, and increases again to about 3 percent for accounts with anywhere from $60,000 to $100,000. The rates change weekly, so check for exact rates with your local bank branch.

Some tiered accounts pay no interest at all on balances below a certain threshold. Find out whether that's a realistic sum for you before opening this type of account. Also, be sure to find out if the higher rates of interest apply to your entire balance or just to the portion above the minimum needed to receive that rate. Finally, keep in mind that transaction fees for tiered accounts tend to be considerably heftier than those for a traditional savings account.

Considering Guaranteed Investment Certificates

If your savings grow to the point where you have more money than you think you need anytime soon, congratulations! One of the places you can consider depositing some of the balance is a *guaranteed investment certificate (GIC)*.

A GIC is a certificate for a deposit of funds in a financial institution. Like savings accounts and money market accounts, GICs are investments for security. These are sometimes called term deposits.

With a GIC, you agree to lend your money to the financial institution for a number of months or years. You can't touch that money for the specified period of time without being penalized.

Why would a financial institution need you to loan it money? Typically, institutions use the deposits they take in to fund loans like mortgages or other investments. If an institution primarily issues car loans, for example, it's apt to pay attractive rates to lure money to four-year or five-year GICs, the typical car-loan term.

Generally, the longer you agree to lend your money, the higher the interest rate you receive. The most popular GICs are for six months, one year, two years, three years, four years, or five years. There is no fee for buying a GIC.

When you deposit the money (a minimum of $500 or $1,000 at most Canadian institutions) for the specified amount of time, the financial institution pays you a higher rate of interest than if you put your money in a savings or chequing account that offers immediate access to your money. When your GIC matures (comes due), the institution returns your deposit to you, plus interest.

The institution notifies you of your GIC's maturation by mail or phone and usually offers the option to roll the GIC over into another GIC. When your GIC matures, you can call your institution to find out the current rates and roll the money over, or transfer your funds into another type of account.

Some institutions give you a grace period, ten days or so, to decide what to do with your money when the GIC matures. In most cases, though, you can specify in advance what should happen to the money by giving your bank instructions for maturation when you buy the GIC. At a CDIC-insured financial institution, your investment is guaranteed to be there when the GIC matures up to $100,000.

Financial advisers say that GICs make the most sense when you know you can invest your money for one year, after which you'll need the money for some purchase you expect to make. The main reward of investing in GICs is that you know for sure what your return will amount to and can plan around it. That's because GIC rates are usually set for the term of the certificate. Be sure to check on the interest rate terms, though, because some institutions change their rate weekly.

GICs are most useful as an investment when interest rates are high, as they were back in the 1980s. These days, consistently lower interest rates mean Canadians should at least consider other types of investments that are both safe and will probably earn more money over the same period of time.

The interest rates paid on GICs are contingent on many factors. While they do tend to reflect prevailing interest rates in the general market, GICs have administered rates, meaning financial institutions use discretion when setting them. For example, banks may increase rates during RRSP contribution season to attract investors. This also means rates are negotiable, depending on the size of the deposit and the relationship between the bank and the client.

Because of this flexibility, it pays to shop around for GIC specials to get the best interest rate. Remember to check out the rates at credit unions, as well as Web-based institutions like ING Direct (`ingdirect.ca`).

If you want your money back before the end of the GIC's term, you will be heavily penalized, usually with the loss of several months' worth of interest. A second drawback is that GICs are taxable at a high rate. Whatever interest you earn (including earnings from the market-linked GICs discussed below) must be reported as taxable income, and is fully taxable on an annual basis. That means your financial institution will report the interest you earned during each tax year to the Canada Revenue Agency (CRA). You will pay tax on that amount annually — despite the fact that you might not see the interest until the GIC matures.

If rates are low, you may want to purchase shorter-term GICs and wait for rates to rise. This way, you won't be tying up your funds for long periods of time while rates might be climbing. As another option, some banks might allow you to add money to a GIC account at the interest rate of that particular day. The advantage to this method is that if you open the account on a day when the rate is low, you can increase your earnings by adding money later, at a higher rate.

Before you buy a traditional GIC or term deposit, ask about the relatively new market-linked GICs being offered by many of Canada's big financial institutions. Market-linked GICs are tied to the performance of the stock market. Like GICs, your principal is guaranteed. You won't lose any of your original investment, no matter how much the stock market fluctuates. But with a market-linked GIC, instead of receiving a fixed rate of interest, your return depends on the value of the stock market during the term of your deposit. If the stock market performs well, this will probably give you a bigger return than you could get with a traditional GIC — although most financial institutions might impose a maximum cap. If the market plummets, however, you will end up with the same amount you invested in the first place. This market-linked GIC allows you to gamble with only your rate of return or interest. You don't gamble with your principal or your original deposit.

See Table 2-1 for some suggested uses for entry-level investments.

Table 2-1 Uses for Entry-Level Investments

Type of Investment	*Suggested Use*
Savings account or tiered account	Tuck away some money in a traditional or tiered chequing or savings account to allow you to access it quickly for emergencies, such as car repairs or dentist bills.
Guaranteed investment certificate (GIC) or term deposit	GICs and term deposits are good investments if you're saving for larger-ticket items such as a down payment on a car or a major appliance — items you don't intend to purchase for at least a year.

Chapter 3

Stocks, Bonds, Mutual Funds, and Real Estate

In This Chapter

- Discovering stocks
- Understanding bonds
- Making sense of mutual funds
- Realizing the potential of real estate

The investments this chapter describes carry a great potential for return — but that possibility of return comes at a greater risk to your money. Stocks, bonds, mutual funds, and real estate are investment options whose values fluctuate with the market, meaning the values of these investments can grow and shrink greatly. However, the information in this chapter empowers you to make good educated guesses about how to pursue these investments.

Sizing Up Stocks

A stock is a piece of paper that signifies you own part of a company. The actual pieces of paper have almost completely gone the way of the dodo bird, replaced by electronic units held in trust for you at your investment dealer's computer. Stocks are also called shares. When you buy a stock, you become a shareholder of that company. The market price of a stock is directly related to the company's anticipated profits and losses. In other words, when the company profits, the value of your stock increases. When the company falters and its profits decline, so does the value of your stock.

Investors who buy stock own shares of the company. That's why they're called shareholders.

Understanding how stocks work

Companies issue stock to raise money to fund a variety of initiatives, including expanding, developing new products, acquiring other companies, or paying off debt. In an action called an *initial public offering* (IPO), a company opens sale of its stock on the stock market for the first time to investors.

An investment banker underwrites the public stock offering, by advising the company when to go public and what price the stock should be at that time.

When the stock begins selling, the price can rise or fall from its initial price depending on whether investors believe the stock was fairly and accurately priced. Sometimes the price of an IPO soars during the first few days of trading, but then falls back to more realistic levels.

After the IPO, stock prices will continue to fluctuate based on what investors are willing to accept when they buy or sell the stock. In simple terms, stock prices are a matter of supply and demand. If everyone wants a stock, its price rises, sometimes sharply. If, on the other hand, investors are fearful that, for example, the company's management is faltering and has taken on too much debt to sustain strong growth, they may begin selling in noticeable volume. Mass sales drive the price down when more sellers exist than buyers. In addition to specific company issues, the price can drop for other reasons, including bad news for the entire industry or a general downturn in the economy.

Stocks are bought and sold on stock exchanges, such as the Toronto Stock Exchange (TSX) (which became the TMX in 2008), as well as on exchanges around the world, like the New York Stock Exchange and the Tokyo Stock Exchange. Companies that don't have the cash reserves necessary to be listed on one of the exchanges are traded *over the counter,* which means they receive less scrutiny from analysts and large investors such as mutual fund managers.

In addition, professional analysts who are paid to watch companies can give a thumbs-up or a thumbs-down to a stock, which in turn can send stock prices soaring or plummeting. The analyst's job is to watch public companies and their managers and report the results of their research.

While carefully monitoring a company's expected earnings, corporate strategies, new products and services, and legal and regulatory problems and victories, analysts give stocks a buy, sell, or hold rating. Such opinions can have a wide-sweeping impact on the price of a stock, at least in the short term. Rumblings, real or imagined, can send the price of a stock, or the stock market overall, tumbling downward or soaring skyward.

The price of a stock goes up and down — a phenomenon known as *volatility* — but if the news creating the stir is short-term, panic is an overreaction. You don't want to sell a stock when its price is down only to see it make a natural recovery a few days, weeks, or even months down the road.

Smart investors who have done their research and are invested for the longer term won't be impacted by short-term price dips or panics. Unless, of course, you use the opportunity to buy a stock you've already researched and were going to buy anyway. The old adage "buy low, sell high" holds as true today as it has since the beginning of time.

How low and how fast can stock prices go? Way back in October 1987, the much-watched Dow Jones Industrial Average (DJIA) tumbled by 22.6 percent in a matter of days. This rapid decline meant the value of a $10,000 investment dropped to $7,740. Most stocks recovered, but some did not. On Bay Street, the S&P/TMX Index (then known as the TSE 300 Composite Index) quickly lost 11.32 percent of its value. Although the recent bear market was even more vicious, it took a period of years before it bottomed out. (A *bear market* is generally defined as a market in which stock prices drop 20 percent or more from their previous high.)

Today, only a few of us could truly say we predicted in early 2000 the stock market free-fall that would grow to become a main story for the first three years of the new millennium. This change in course was a far cry from the 1994 to 1999 time period where many of us witnessed the greatest bull market in generations — many of us saw both the best and the worst of stock market volatility in one lifetime! (A *bull market* refers to a period of optimism in the stock market, when prices hit new highs.)

You can lose all your money with a stock investment, and that risk is why you need to analyze your choices carefully and seek sound investment advice.

Stock investing carries certain risks, but those risks can be minimized by careful investment selection and by diversification, a technique for building a balanced portfolio, which you can investigate more thoroughly in Chapter 5.

Recognizing different types of stock

Companies issue two basic kinds of equity, *common stock* and *preferred shares*. Each type provides shareholders with different opportunities and rights:

- **Common stock:** Represents ownership in a company. Companies can pay dividends to their shareholders. Dividends are paid out from a company's earnings and can fluctuate with the company's performance. Common stock dividends are paid only after the preferred stock dividends are paid. ***Note:*** Not all companies pay dividends.

Common stock offers no performance guarantees, and although this kind of stock historically has outperformed other types of investments, you can lose your entire investment if a company does poorly enough to wipe out its earnings and reputation into the foreseeable future.

- **Preferred shares:** Constitute ownership in shares as well, but differ from common stock in ways that reduce risk to investors but also limit upside potential. Dividends on preferred shares are paid before common stock, so preferred shares may be a better bet for investors who rely on the income from these payments. But the dividend, which is usually fixed, is not increased when the company enjoys higher profits, and the price of preferred shares increases more slowly than that of common stock. Also, preferred share investors stand a better chance of getting their money back if the company declares bankruptcy.

A company's common stock is also categorized depending on its perceived expected performance. Basically, a company's stock falls into one of two categories: *growth* or *value* — see Table 3-1 for a summary of each. (A third category, income stocks, is not discussed here.)

Table 3-1 Differences between Growth Stocks and Value Stocks

Investor Characteristic	*Pros*	*Cons*
Growth stocks	Investors anticipate higher profits in return for higher stock prices. The return on investment can be substantial and prove worth the risk.	They are less likely to pay dividends; and if they do, they're typically lower than that of value stocks. Stock prices tend to be affected by negative company news and short-term market changes.
Value stocks	Investors anticipate the company will experience a turnaround that will produce higher profits in the future. It costs fewer investment dollars to buy a dollar of their profits.	They may never realize the potential that investors project onto them.

Over time you're likely to buy a mix of both growth and value stocks for your portfolio, so knowing the different characteristics of each is important. Understanding growth and value stocks can help you evaluate your options more carefully.

Growth companies are typically organizations with a positive outlook for expansion and, ultimately, stock prices that move upward. Investors looking for growth companies usually are willing to pay a higher price for stocks that have consistently produced higher profits — they're betting the companies will continue to perform well in the future.

Because they use their money to invest in future growth, growth companies are less likely to pay dividends than more conservative companies; when they do pay dividends, the amounts tend to be lower. An investor who buys a growth stock believes that, according to analysis of the company's history and statistics, the company is likely to continue to produce strong earnings and is therefore worth its higher price.

The stock of a growth company is, however, somewhat riskier because the price tends to react to negative company news and short-term changes in the market. Also, the company may not continue to produce earnings that are worth its higher price.

In contrast, value stocks are out of favour, left on the shelf by investors who are busy reaching for more expensive and trendier items. For that reason, you spend fewer dollars to buy a dollar of their potential profits than if you invest in a growth stock. When investors buy value stocks, they're betting that they're actually buying a turnaround story — with a happy ending down the road.

Value companies carry risk too, because they may never reach what investors believe is their true potential. Optimism doesn't always pay off in profits.

Identifying potential stock investments

To determine which stocks are potential investments, stick with stocks relating to your own interests or knowledge. If you frequent particular stores or restaurants and you use and like their products and services, find out if they are publicly held companies. Start identifying and watching these stocks. That advice doesn't mean you should buy the stock right away. You still have some homework to do.

The following list tells you what to look for when investigating potential stock investments. Investment publications such as *The Investment Reporter* (`investmentreporter.com`), *Investor's Digest of Canada* (`www.investorsdigestofcanada.com`), and *Blue Book of Stock Reports* (`www.bluebookofstockreports.com`), along with the U.S. publication *Value Line*

(www.valueline.com) and any investment dealer's analyst report, can provide you with many or all of the following pertinent facts and measures:

- **Find out if the industry is growing.** Some industries aren't. News stories can tell you the state of the industry (also check out *The Globe and Mail Report on Business, National Post FP Investing,* or *Canadian Business* magazine). The company's annual report can also be a useful source for this kind of information.

  Company shareholder departments can provide you with copies of annual reports and quarterly reports that companies must file. You can also find them at major public libraries, or on the Internet at www.sedar.com. (Sedar.com, by the way, is an essential site for you to become familiar with because it holds critical and current company information.) Keep in mind that after you buy a stock, thereby becoming a shareholder, the company is required by law to send you a copy of its annual reports if you request them — and they're free.

- **Find primary competitors.** Don't look at a stock in isolation. A company that looks enticing by itself may look like a 100-pound weakling when you evaluate its strengths and weaknesses next to the leading competitors in the industry. Check out at least two competitors of any stock you're evaluating.

- **Check out annual earnings and sales.** This is key in deciphering how quickly a company is growing over one-year, three-year, and five-year time periods, and whether its earnings are keeping pace with sales. Look for growth rates of at least 10 percent.

- **Look at the stock's price-to-earnings (P/E) ratio.** This is the primary means of evaluating a stock. The P/E ratio is derived by dividing the share price by its earnings per share. The result tells you how much investors are willing to pay for each $1 of earnings. Those stocks that have faster earnings growth rates also tend to carry higher P/Es, which means investors are willing to pay through the nose to own shares. The value of a P/E ratio, however, can be subjective. One investor may think a particular company's P/E ratio of 20 is high, while another may consider it low to moderate.

- **Find out the price-to-book value (P/B) ratio.** The P/B ratio is the stock's share price divided by book value, or a firm's assets minus its liabilities. This ratio is a good comparison tool and can tell you which companies are asset-rich and which are carrying more debt.

  A low P/B ratio can be an indicator that a stock may be a good value investment.

- **Check out the stock's price-to-growth flow ratio.** This ratio is the share price divided by growth flow (annual earnings plus research and development costs) per share. This is a useful measure for assessing fast-moving companies, especially in the technology sector, where management often puts profits back into product development.
- **Look at the stock's PEG ratio.** The PEG ratio is a company's P/E ratio divided by its expected earnings' growth rate and is an indicator of well-priced stock.
- **Look ahead.** Projections of five-year annual growth rates and five-year P/E ratios can tell you whether analysts believe the companies you're evaluating can continue to grow at their current rate, can beat it, or will start to fall behind.

Make a list of the stocks you're interested in and watch their performance over time. Doing so gives you a feel for how the stocks respond to different types of economic and market news. You can also see which stocks' prices are more volatile.

So, does your own analysis indicate you have a winner on your hands, or a dog? If you're unsure, sit tight and watch what happens in the weeks and months ahead. Watching several stocks over a period of time not only tells you how well they're doing, or not doing, but also can show you how well you're honing your stock analysis skills.

Bantering about Bonds

A bond is basically an IOU. When you purchase a bond, you are lending money to a government, municipality, corporation, federal agency, or other entity. In return for the loan, the entity promises to pay you a specified rate of interest during the life of the bond and to repay the face value (the principal) of the bond when it matures (or comes due).

When you buy a new bond from the original issuer (the entity to whom you're lending your money), you will purchase it at face value, also called par value, and you will be promised a specific rate of interest, called the coupon. If you buy a second-hand bond that's already been resold before maturity (from what's called the secondary market, where existing bonds are bought and sold), you may buy it at a discount (less than par) or at a premium (above par).

Bonds aren't like stocks. You are not buying part ownership in a company or government when you purchase a bond. Instead, what you're actually buying — or betting on — is the issuer's ability to pay you back with interest.

Understanding how bonds work

You have a number of important variables to consider when you invest in bonds, including the stability of the issuer, the bond's maturity or due date, interest rate, price, yield, tax status, and risk. As with any investment, ensuring that all these variables match up with your own investment goals is key to making the right choice for your money.

Be sure to buy a bond with a maturity date that tracks with your financial plans. For instance, if you have a child's postsecondary education to fund 15 years from now and you want to invest part of his or her education fund in bonds, you need to select vehicles that have maturities matching that need. If you have to sell a bond before its due date, you receive the prevailing market price, which may be more or less than the price you paid.

In general, because they often specify the yield you'll be paid, bonds can't make you a millionaire overnight like stocks can. What can you expect to earn? That depends on a number of factors, including the type of bond you buy, and market conditions, like prevailing interest rates. What can you expect to lose? That depends on how safe the issuer is. The consensus, especially for novice investors, is to steer clear of anything not rated A or above by the credit rating agencies such as the Dominion Bond Rating Service (DBRS) (`www.dbrs.com`).

Recognizing different types of bonds

Bonds come in all shapes and sizes, and they enable you to choose one that meets your needs in terms of your investment time horizon, risk profile, and income. First, here is a look at the different types of Government of Canada securities available:

- **Treasury bills:** T-bills are offered in 3-month, 6-month, and 12-month maturities. These short-term government securities do not pay current interest but instead are always sold at a discount price, which is lower than par value. The difference between the discount price and the par value received is considered interest (and is taxed as income). For example, if you pay the discount price of $950 for a $1,000 T-bill, you pay 5 percent less than you actually get back when the bill matures. Par is considered to be $100 worth of a bond (which, although selling for a $1,000 minimum, is always expressed in a $100 measure for the purpose of valuation). The minimum investment for T-bills is $5,000, but you can subsequently purchase them in $1,000 increments.

- **Government of Canada bonds:** Unlike T-bills, Government of Canada bonds have fixed coupons that pay a specific interest at regular intervals (every six months). These bonds are longer-term offerings than T-bills, with maturities of between 1 and 30 years. Typically, the longer the term, the higher the interest paid. The minimum investment is lower than for T-bills, just $1,000. But they are also issued in larger denominations. The interest you earn on Government of Canada bonds is considered income and is taxed as such. If the market value of your bond increases and you sell your bond for more than what you paid, this is considered a capital gain.
- **Strip or zero-coupon bonds:** Strip bonds, so named because the coupon has been "stripped" from the bond's principal, work almost like T-bills. They are sold at a steep discount, and interest accrues (builds up) during the life of the bond. At maturity, the investor receives all the accrued interest plus the original investment. Strip bonds are guaranteed by corporations as well as provincial and federal governments, and can be sold anytime. As with T-bills, the difference between the discounted price you pay for a strip bond and the value at maturity is considered interest income, and is fully taxed.
- **Canada Savings Bonds (CSBs):** These have long been a fall investment ritual for Canadians. You purchase Canada Savings Bonds from your bank, trust, credit union, or investment dealer during the annual selling season, which runs from October 1 to April 1. The bond is registered to you and is non-transferable. The value of the bond itself never changes, so these bonds are not tradeable.

  Quite simply, by buying a Canada Savings Bond you are lending your money to the federal government in return for interest. With a regular-interest CSB, that gain is paid out once a year, on November 1, and is taxable as interest income. With compound-interest CSBs, your interest is reinvested until maturity, thereby compounding your gains — but, as of 1990, you still have to claim it as income each year. For more zest, the government also offers an indexed CSB, which takes into account rising interest rates. The bond's yield is based on the inflation rate plus a fixed rate of return. For more information on CSBs, visit the federal government's Canada Savings Bond Web site at `www.cis-pec.gc.ca`.

While Government of Canada bonds are some of the safest investment bets around — because they're guaranteed by the strength of the federal government — remember that risk and reward are tradeoffs you need to look at in tandem. As with all investments, the safer the investment the less you're likely to earn or lose!

The following are other types of available bonds:

- **Provincial bonds:** Provincial governments issue both T-bills and bonds (short-, medium-, and long-term), much like the federal government. While these are safe investments, bonds issued by provinces facing economic uncertainty, like Quebec or Newfoundland, are considered slightly more risky by investors. In return for the added risk, they usually pay a slightly higher yield.
- **Municipal bonds:** These are loans you make to a local government, whether it's in your city or town.
- **Commercial paper:** These are short-term debt instruments employed by both publicly owned Crown corporations (referred to as government guaranteed commercial paper) and private-sector corporations. Like T-bills and strip bonds, they are sold at a discount, but yields tend to be higher.
- **Corporate bonds:** A growing area in Canada, these are issued by companies that need to raise money, including public utilities and transportation companies, industrial corporations and manufacturers, and financial services companies.

  Corporate bonds can be riskier than either Canadian government bonds or provincial bonds because companies can go bankrupt. So a company's credit risk is an important tool for evaluating the safety of a corporate bond. Even if an organization doesn't throw in the towel, its risk factor can be enough to cause agency analysts to downgrade the company's overall rating. If that happens, you may find it more difficult to sell the bond before maturity.
- **Junk bonds:** Junk bonds pay high yields because their issuers may be in financial trouble, may have a poor credit rating, and may be likely to have a difficult time finding buyers for their bonds. Although you may decide junk bonds or junk bond mutual funds have a place in your portfolio, make sure that spot is small because these bonds carry high risk.

  Although junk bonds may look particularly attractive at times, think twice before you buy. They don't call them junk for nothing. You could potentially suffer a total loss if the issuer declares bankruptcy. As one wag suggested, if you really believe in the company so much, invest in its stock, which has unlimited upside potential.

Identifying potential bond investments

Here's a look at some items you need to evaluate before investing in a bond:

- **Issuer stability:** This is also known as credit quality, which assesses an issuer's ability to pay back its debts, including the interest and principal it

owes its bond holders, in full and on time. Although many corporations, the Canadian government, and the provinces have never defaulted on a bond, you can expect that some issuers can and will be unable to repay.

- **Maturity:** A bond's maturity refers to the specific future date when you can expect your principal and final interest to be repaid. Bond maturities can range from as short as one day all the way up to 30 years. Make sure the bond you select has a maturity date that works with your needs. T-bills and strip bonds pay interest at maturity. All other bonds pay interest twice yearly or quarterly. Most investors buy bonds in order to have a steady flow of interest income.

  The longer the maturity in a bond, the more risk is associated with it — that is, the greater the fluctuation in bond value based upon changes in interest rates and credit rating.

- **Interest rate:** Bonds pay interest that can be fixed-rate, floating, or payable at maturity. Most bond rates are fixed until maturity, and the amount is based on a percentage of the face or principal amount.

- **Face value:** This is the stated value of a bond. The bond is selling at a premium when the price is above its face value; pricing below its face value means it's selling at a discount.

- **Price:** The price you pay for a bond is based on an array of different factors, including current interest rates, supply and demand, credit rating, and maturity.

- **Current yield:** This is the annual percentage rate of return earned on a bond. You can find a bond's current yield by dividing the bond's interest payment by its market value. For example, if a bond has a current value of $900 and its interest rate is 8 percent (0.08), the current yield is 8.89 percent — 8 percent or 0.08 ÷ $900 = 8.89.

- **Yield to maturity (YTM):** This tells you the total return you can expect to receive if you hold a bond until it matures. Its calculation takes into account the bond's face value, its current price, and the years left until the bond matures. The calculation is an elaborate one, but the broker you're buying a bond from should be able to give you its YTM. The YTM also enables you to compare bonds with different maturities and yields.

  Don't buy a bond on current yield alone. Ask the bank or brokerage firm from which you're buying the bond to provide a YTM figure so you can have a clear idea about the bond's real value to your portfolio.

- **Tax status:** Outside your RRSP, the return you earn on bonds is fully taxable as interest income. The difference between what you paid for a discounted bond and the value at maturity is also considered income. Gains you make on the value of a bond if you sell it before maturity are considered a capital gain. You will be taxed on 50 percent of your capital gains annually.

Defining Mutual Funds

A *mutual fund* is managed by an investment company that invests (according to the fund's objectives) in stocks, bonds, government securities, short-term money market funds, commodities, currencies, gold, real estate, and other instruments by pooling investors' money.

Mutual funds are sold in *shares* (also known as *units*). Each share of a fund represents an ownership in the fund's underlying securities (the portfolio).

Investors can sell their shares at any time and receive the current share price, which may be more or less than the price they paid.

When a fund earns money from interest or dividends on the securities it invests in, or makes money by selling some of its investments at a profit, the fund might distribute dividends to shareholders. Investors may decide to reinvest these dividend distributions automatically in additional fund shares, or receive distributions in cash.

A mutual fund investor makes money from the distributions and also can potentially make money as the fund's share (called *net asset value per share,* or NAVPS) increases in value.

> NAVPS of a mutual fund = Assets – Liabilities ÷ Number of shares in the fund

Assets are the value of all securities in a fund's portfolio; liabilities are a fund's expenses. The NAVPS of a mutual fund is affected by the market value of the securities in the fund and by any dividend or capital gains distributions to its shareholders.

Unless you're in immediate need of this income, which might be taxable, reinvesting this money into additional shares is an excellent way to grow your investments. This holds especially within your RRSP, where the gains and distributions will be sheltered from immediate taxes.

Mutual fund owners receive a portion of the distribution of dividends and capital gains based on the number of shares they own. As a result, an investor who puts $1,000 in a mutual fund gets the same investment performance and return per dollar as someone who invests $100,000 or even a million bucks. Nicely democratic!

Mutual funds invest in many (sometimes hundreds of) securities at one time, so they are *diversified* investments. A diversified portfolio is one that balances risk by investing in a number of different areas of the stock and/or bond markets as well as commodities, currencies, gold, real estate, derivatives, or

indices. This type of investing attempts to reduce volatility and minimize losses over the long term as markets change. Diversification offsets the risk of putting your eggs in one basket, such as in technology funds. (See Chapter 5 for a detailed discussion of diversification.)

A stock or bond of any one company represents just a small percentage of a fund's overall portfolio. So even if one of a fund's investments performs poorly, 20 to 150 more investments can shore up the fund's performance. As a result, the poor performance of any one investment isn't likely to have a devastating effect on an entire mutual fund portfolio. That balance doesn't mean, however, that funds don't have inherent risks: You and your adviser need to carefully select mutual funds to meet your investment goals and risk tolerance.

The performance of certain classes of investments — such as large company growth stocks — can strengthen or weaken a fund's overall investment performance if the fund concentrates its investments within that class. If the overall economy declines, the stock market takes a dive, or a mutual fund manager picks investments with little potential for growth, a fund's performance can suffer.

Unfortunately, unless you have a crystal ball, you have no way to predict how a fund will perform, except to look at the underlying risk. If a fund manager has managed long enough to build a track record through ups and downs, you can review his/her performance during the last stressful market.

Fortunately for all investors, most funds use a statistical measure called *standard deviation,* which measures the volatility in the fund's performance. The larger the swings in a fund's returns, the more likely the fund will slip into negative numbers.

Periodicals that report on and rank mutual funds include *All-Canadian Mutual Fund Guide* and *Canadian Mutual Fund Adviser,* available on newsstands or at your library. Or check out `www.morningstar.ca` or `www.globefund.com` for similar information.

Considering different types of mutual funds

As you prepare to invest in mutual funds, you need to decide which types of funds best suit your goals and tastes. Basically, you have the following general types of mutual funds to consider:

- Equity funds, which invest in Canadian and foreign stocks
- Bond funds (also considered income funds), which invest in bonds

- Balanced funds, also called hybrid funds, which invest in both stocks and bonds
- Money market funds, which hold short-term investments
- Commodity, currency, gold, real estate, and index funds (we bet you can guess what these funds invest in)
- Ethical funds, with investing decisions guided by moral criteria

Table 3-2 gives you a sense of how many dollars investors allocated to different types of mutual funds in mid-2006 and the change in those numbers in just one year to mid-2007.

Table 3-2 Mutual Fund Assets in July 2006 and July 2007

Fund Type	*Total Net Assets July 2006*	*Net Assets July 2007*
Canadian equity funds	$119 billion	$149 billion
Bond and income funds	$64 billion	$55 billion
Domestic balanced funds	$158 billion	$156 billion
Foreign equity funds	$98 billion	$113 billion
U.S. equity funds	$39 billion	$25 billion
Canadian money market funds	$42 billion	$49 billion

Source: The Investment Funds Institute of Canada (www.ific.ca)

Each of these groups presents a wide variety of funds with different characteristics to choose from. To help you further refine your search and match fund investments to your goals, the following list offers a general look at some different types of funds available. Equity funds also include:

- **Aggressive growth funds and venture funds:** Managers of these funds are forever on the lookout for undiscovered, unheralded companies, including small and undervalued companies. The goal is to get in when the stock is cheap and realize substantial gains as it soars skyward. That dream doesn't always come true. But if you're willing to accept above-average risk, you may reap above-average gains.
- **Growth funds:** These funds are among the mainstays of long-term investing. They own stocks in mostly large- or medium-sized companies whose significant earnings are expected to increase at a faster rate than that of the rest of the market. These growth funds do not typically pay dividends. Several types are available, including large-, medium-, and small-company growth funds.

- **Value funds:** Managers of these funds seek out stocks that are underpriced — selling cheaply relative to the stock's true value. The fund's manager believes the market will recognize the stock's true price in the future. Stock price appreciation is long term. These funds don't typically turn in outstanding performance when the stock market is zooming along but tend to hold their value a good deal more than growth funds when stock prices slide, and so are generally believed to be good hedges to more growth-oriented mutual funds. These funds come in large-, medium-, and small-company versions.
- **Growth and income funds or equity income funds:** These funds were developed to balance investors' desires for current income with some potential for capital appreciation. These fund managers invest mostly in stocks — often blue-chip stocks — that pay dividends. They usually make some investments in utility companies and banks, which are also likely to pay dividends.
- **International and global funds:** These two funds may sound like the same type of mutual fund, but they're not. International funds invest in a portfolio of stocks (international securities) outside of North America. Global funds, also called world funds, can invest anywhere in the world, including the United States and Canadian stock markets.
- **Sector funds:** The managers of these funds concentrate investments in one sector of the economy, such as financial services, real estate, technology, or precious metals. Although these types of funds may be a good choice after you've built a portfolio that matches your investment plan, they have greater risk than almost any other type of fund because these funds concentrate their investments in one sector or industry.

  If you're uncomfortable with the potential for significant losses, make sure a sector fund accounts for only a small percentage of your portfolio — say, less than 10 percent. Remember, however, that if you invest in a balanced portfolio, your other investments should hold their own if only one industry is impacted.
- **Emerging market/country funds:** The managers of these funds seek out the stocks of underdeveloped economies, such as in Asia, Eastern Europe, and Latin America. Finding undiscovered winners can prove advantageous, but an emerging market fund isn't a recommended mainstay for new investors because of the potential for loss. When these countries and economies suffer economic decline, they can create significant investor losses.
- **Regional or national funds:** As their name implies, the managers of these funds look for the stock winners of one specific region or country of the world. Unless you have close relatives running a country somewhere and have firsthand knowledge about that land's economic prospects, you're wise to closely monitor these funds. The reason is simple: risk comes with concentration in one area. For example, when Japan's economy declined in 1997, it sent Japanese mutual funds tumbling by more than 40 percent and they stayed down for several years.

- **Index funds:** The managers of these funds invest in stocks that mirror the investments tracked by an index such as the S&P/TMX Composite Index. Some of the advantages of investing in index funds include low operating expenses and diversification. Although they don't necessarily rely on the performance of any one company or industry to buoy their performance, they do invest in equities that represent a market — such as the Toronto Stock Exchange. If and when that market dips, as the S&P/TMX did between 2000 and 2003, it can dip significantly. The S&P/TMX went from a high of about 11,000 in mid-2000 to the 7,000 level in 2003, a staggering drop of more than 35 percent in a relatively short period of time. In late 2007 it was trading at about 14,000. So what goes down may eventually go up as well!

Bond funds are less risky than stock funds, but also potentially less rewarding. You can choose from the following types of bond funds:

- Government of Canada bonds
- Provincial bonds
- Corporate bonds
- High-income (aka junk) bonds
- Chartered bank bonds
- International bond funds

Balanced and asset allocation funds are another investment option. These funds are a mix of stocks and bonds that are also called blended or hybrid funds. Generally, managers invest in about 60 percent stocks and 40 percent bonds. Balanced funds appeal to investors because even in bear markets, their bond holdings allow them to pay dividends.

Money market funds are designed as the least volatile type of mutual fund. Fund managers invest in instruments such as short-term bank GICs, Government of Canada and provincial Treasury bills, bankers' acceptances, and short-term corporate debt issued by companies with good credit ratings. This type of mutual fund is ideal for people who may need money in the short term, perhaps for a down payment on a home, or need a place to park money for future investment decisions.

Analyzing mutual funds

As you begin your search for mutual funds, make sure your performance evaluation produces meaningful results. Performance is important because good, long-term earnings enable you to maximize your investment. Gauging future performance is not an exact science.

When you evaluate funds, check out publications like *Canadian Mutual Fund Adviser* or *Investor's Digest of Canada,* available by subscription, on newsstands, or at the library. A fund's prospectus, which you can request from the fund's toll-free phone number, also outlines the important features and objectives of the fund.

As an additional check, compare all your choice funds before making a final decision; avoid choosing one fund in isolation. A single fund can look spectacular until you discover it trails most of its peers by 10 percent.

Look for the following information when you select mutual funds:

- **One-, three-, and five-year returns:** These numbers offer information on the fund's past performance. A look at all three can give you a sense of how well a fund fared over time and in relation to similar funds.

  Avoid the temptation to evaluate funds solely on returns to date. Past performance is no guarantee of future performance. Always look at the big picture, including the rest of the information on this list.

- **Sales charges, commissions, or loads:** These are commissions you pay to a financial planner or investment adviser to buy a fund. A sales charge on a purchase, sometimes called a *front load,* is paid when you buy shares. No-load funds don't charge sales loads. No-load funds exist in every major fund category.

  Front-end loads (charges you pay to your brokerage at the time you purchase your mutual fund shares) are negotiable up to about 5 percent, but you'll find a lot in the 2 percent range. *Back-end loads* (also called deferred sales charges or redemption fees, paid when you sell) are higher, in the 6 to 7 percent range if you need to sell in the first year. Typically, the longer you keep your shares, the lower the back-end load, with the charge going down to zero at about 1 percent every year. Switching from one fund to another fund in the same fund family can usually be done for free at any time. However, all mutual funds (whether load or no-load) have ongoing operating and management expenses.

- **Annual expenses:** Also called *management expense ratios* (MERs), these include both the fees paid to a fund's portfolio managers and a fund's expenses. The MER is always calculated as a percentage of the fund's total assets and is paid out of those assets. Before you settle on one fund, review the numbers on a few competitors. In general, the more aggressive a fund, the more expenses it incurs trading investments. Be cautious if a fund has an extremely high MER compared to that of similar funds. Before you invest, you can find out how a fund's MER has fluctuated over the past five years by reading its annual report.

To develop a sense of how expenses can take a big bite out of earnings over the years, consider this example: A $10,000 investment earns 10 percent over 40 years with a 1 percent expense ratio, which yields a return of $302,771. The same investment with a 1.74 percent expense ratio returns $239,177, or $63,594 less.

If you're making money and getting a good investment service, then don't sweat this MER stuff too much. For the perfect combination, invest in the shares of a public mutual fund company as well as its mutual funds. That way, you'll be earning the fees you're paying. If you like the milk, buy a piece of the cow!

- **Manager's tenure:** Consider how long the current fund manager (or managers) has been managing the fund. If it's only been a year or two, take that into consideration before you invest — the five-year record that caught your eye may have been created by someone who has already moved down the road. Fund managers move around often. In an ideal world, your funds are handled by managers with staying power.
- **Portfolio turnover:** This tells you how often a growth fund manager sells stocks in the course of a year. Selling stocks is expensive, so high turnover over the long run will probably hurt performance. If two funds appear equal in all other aspects, but one has high turnover and the other low turnover, by all means choose the fund with low turnover.
- **Underlying fund investments:** For your own sake, look at the top five or ten stocks or bonds a fund is investing in. For example, a growth fund may be getting its rapid appreciation from a high concentration in fairly risky technology stocks, or a global fund may have many of its holdings here in the Canadian stock market. Neither of these strategies is a mortal sin if you know about and can live with it. If you can't, keep looking for a fund that matches your goals. Looking at underlying investments not only helps minimize your surprises as markets and economies shift, but also enables you to create a balanced portfolio.

Investing in Real Estate

You can become a real estate investor in three ways: first, by buying your own home; second, by buying an investment property; and third, by investing in a real estate investment trust (REIT).

Although it's true that over time real estate owners and investors have enjoyed rates of return almost as good as the stock market, real estate is not a simple way to get wealthy. Nor is it for the faint of heart or the passive investor. Real estate goes through good and bad performance periods, and most people who make money in real estate do so because they invest over many years.

Buying your own home

Most people invest in real estate by becoming homeowners. Canadians have long been taught that the *equity,* which is the difference between the market value of your home and the loan owed on it, increases over time to produce a significant part of your net worth as long as the loan is well managed.

Unless you have the good fortune to live in a rent-controlled apartment, owning a home should be less expensive than renting a comparable home throughout your adult life. Why? As a renter, your housing costs will follow the level of inflation, while as a homeowner, the bulk of your housing costs are not exposed to inflation if you have a fixed-rate mortgage. And if you have a variable rate mortgage, you're enjoying rates that are still reasonable!

Figure 3-1 illustrates the difference in expenditure when comparing owning and renting a home. This graph assumes the homeowner has a 30-year, fixed-rate mortgage of 7.5 percent on $150,000, and the renter starts out with an $800 per month rent payment with annual increases of 4 percent.

Figure 3-1 shows that at the end of 30 years the renter has paid more than $500,000, while the owner has paid less than $375,000. What's more, the owner has increased her equity, also called net worth. Owning your home can add to your sense of financial security as the economy fluctuates. In addition to the financial benefits, homeownership gives you more control over your own living space; for example, it allows you more freedom to decorate your home's exterior and interior according to your own tastes. And the federal government gives homeowners another major financial boost. How? Any profit made when you sell your primary residence is tax-free. This is called the principal residence exemption and each Canadian family is entitled to one.

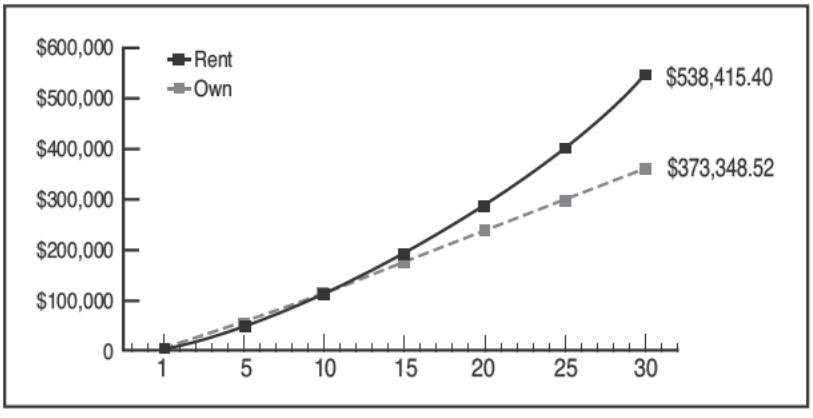


Figure 3-1: The expense of owning versus renting your home.

Buying an investment property

A second way to invest in real estate is to buy residential housing such as single-family homes or multi-unit buildings, and rent them. In many ways, buying real estate in this way isn't an investment; it's a business. Maintaining a property can easily turn into a part-time job. If you're a person who dreams of putting heart and soul into a property, however, it may be worth investigating. If you do decide to take this route, first, be sure you have sufficient time to devote to the project. Second, be careful not to sacrifice contributions to your RRSP in order to own investment real estate. Finally, don't forget that all rent you collect is taxable after expenses and so is the profit (if any) on investment real estate. The bank and the tax man both win before you do in the property business, so to succeed you really have to know what you're doing.

Deciding to become a real estate investor depends mostly on you and your situation. Ask yourself the following questions: Is real estate something you have an affinity for? Do you know a lot about houses, or have a knack for spotting up-and-coming areas? Are you cut out to handle the responsibilities that come with being a landlord? Do you have the time to manage your property?

Another drawback to real estate investment is that you earn no tax benefits while you're accumulating your down payment, whereas your RRSP gives you an immediate tax deduction as you contribute money to it. If you haven't exhausted your contributions to your RRSP, consider doing so before taking a look at investment real estate.

Investing in a real estate investment trust (REIT)

A *real estate investment trust (REIT)* is a "company." Although legally structured as a closed-end investment trust that owns, maintains, and manages real estate, most REITs boast an enterprising, internal management running a truly sophisticated organization. Most Canadian and U.S. REITs are publicly traded on major Canadian and U.S. stock exchanges. These public REITs have their own ticker symbols and trade in the same way common stocks do.

In the United States, more than 250 publicly traded REITs exist to choose from, including more than 20 from Canada. And in the same way a mutual fund can provide you with a basket of publicly traded companies, a REIT lets you hold virtually any form of commercial real estate out there: office towers, malls, apartments, hotels, storage facilities, and even prisons! REITs buy real estate, manage it, develop it on their own (to a limited degree), or do a combination of these things.

During the recent bear market, investors flocked to REITs as a defensive haven of sorts. REITs also remain popular because they do the following:

- Provide generally positive returns over the long term
- Expose investors to lower risk and provide higher stability relative to stocks
- Provide generous distribution yields when compared to like income-generating instruments
- Offer capital appreciation potential
- Possess deferred tax payments and reduced tax rates
- Trade quickly and easily on major exchanges
- Represent a creative way to hold small chunks of real estate
- Benefit from good management in most cases
- Combine the best features of real estate, stocks, and mutual funds
- Are considered mainstream and proven by Canadian and U.S. investors
- Require no active management on your part

REITs have some very special and significant tax benefits to the unitholder. A portion of distributions from a REIT will not be immediately included in your current year's taxable income. However, in the current year, you are required to reduce your units' tax cost base by the amount paid or payable to you by a REIT. You will realize a higher capital gain (on a lower adjusted cost base) when the unit is sold at a future date. Depending on the REIT's structure and circumstances, you can receive up to 100 percent of the cash distribution in this tax-deferred manner. This deferral represents one of the key tax benefits associated with REITs.

Of course, REITs have disadvantages, too, including the following:

- **Real estate risks:** Owning shares in a REIT carries the same investment risks as any real estate investment. If the properties owned by the REIT are in trouble, so is the REIT.
- **Less profit than direct real estate investing:** That's the tradeoff. Because REITs offer less risk than buying real estate on your own, they might also offer a lower return on your investment.

When you're looking for a REIT to invest in, analyze it the way you would analyze a property. Look at the location and type of the property. If shopping malls are booming in Vancouver, and your REIT buys and sells shopping malls in Vancouver, then you'll do well. However, if your REIT invests in office buildings across the country and the Canadian office building market is overbuilt and having tough times, so will you.

Chapter 4

Monitoring Your Progress

In This Chapter

- Monitoring your investments
- Tracking the right indices
- Knowing what to expect from the markets' highs and lows

This chapter tells you how to assess the performance of your investments — or those you plan to buy — relative to their peers. It also provides you with tools to determine how the stock and bond markets, and the mutual funds that invest in them, are doing overall.

Checking Up on Savings Accounts and GICs

Chapter 2 suggests these investments qualify as entry-level, or low-complexity, investments. The same holds true for monitoring their progress.

Traditional savings accounts and tiered accounts

Monitoring your savings account or tiered account is a lot like monitoring your chequing account. You receive statements from the bank or credit union that tell you your balance including accrued interest. Many institutions also have a toll-free telephone number that allows you to access balance information by using your account number and your personal code. In addition, all Canadian financial institutions have online banking where you can access your account information.

Guaranteed investment certificates

When you invest in a guaranteed investment certificate (GIC), you receive a confirmation of the terms of liquidity, the principal you invested, the interest rate, the duration of the investment, and the final amount you will receive. Some institutions include your balance information on the statements you receive from other accounts you have with them.

The most important question with a GIC is what will happen to your money (both the principal and the interest you earn) when the GIC matures. This is your decision. Keep in mind, with GICs, you've agreed to lock in your principal as well as the interest for a specified amount of time. What happens to that money after the term of the GIC is entirely up to you.

Banks and credit unions will generally ask for your instructions for maturity when you buy the GIC. You can instruct them to re-invest the money into another GIC, move it into a different investment, place it in a bank account, or have it returned to you. If the GIC is within your RRSP, you will be subject to a federal upfront withholding tax if you decide to cash it in at maturity instead of reinvesting, and remove the funds from your RRSP. (For more about RRSPs, check out Book VI.)

Most institutions send out a notice a few weeks before your GIC matures. If you want to change your instructions for maturity at that time (or anytime before the maturation date), call your financial institution and let them know.

Looking at Performance: The Indices

An *index* is a statistical yardstick used to gauge the performance of a particular market or group of investments. By tracking the movement of prices of a group of similar investments, such as small- or large-company stocks or bonds, an index produces a benchmark against which you can measure an individual investment's performance.

Think of using an index in the same way you might use a list of comparable home sales when you shop for a house in a neighbourhood. If the list of comparable homes shows you that the average three-bedroom house sells for $300,000, you can't expect to buy a similar house for too much less than that. At the same time, you don't want to pay too much more. Similarly, the benchmarks produced by an index show you a reasonable performance target.

A *return* is an investment's performance over time, usually expressed as an average annual return. If a mutual fund returned 10 percent every year for five years, its average annual return would be 10 percent. Its cumulative return, which totals an investment's performance year after year, would be more than 50 percent for those five years due to compounding.

If an investment's performance over the course of a year is vastly superior or inferior to the appropriate index's return, you'll want to know why. Your investment may be outpacing its peers because it's a lot riskier. A mutual fund, for example, may invest in stocks or bonds that are far riskier than other funds it may resemble. On the other hand, an investment may be lagging its peers simply because it's a poor performer. Bear in mind, however, that you have to build a performance history over time to determine the character of a particular investment.

The following sections look at the indices that are handiest as you determine the expected performance from your investments.

Start by tracking an index that represents or follows your stock or mutual fund. After you become familiar with that index, pick up another index to follow. Do not follow too many indices, though — it can become confusing and time-consuming.

Canadian indices

The number of Canadian stock, bond, and mutual fund indices continues to grow, with more specialized indices popping up over time. The ones described in this section are those you'll see on the daily business pages. Just about everyone in the investment world refers to them, and you will too.

The S&P/TMX Composite Index

The S&P/TMX Composite Index is the best recognized and most consulted Canadian index. It keeps track of the average performance of 300 Canadian large-company stocks trading on the Toronto Stock Exchange (or TMX, which it became in 2008), and is weighted according to market value. An index committee of Standard & Poor's reviews the companies periodically and may replace companies for several reasons, including suitability and diversification.

The performance of member stocks is calculated daily as a measure of the market's rise or fall as well as an overall performance figure. These are the numbers you hear reported on the nightly news and see in newspapers and at finance Web sites.

The S&P/TMX Composite Index tells you the average performance of the stocks in the index. This performance is reported as both numbers and percentages. If the TMX goes up, your newspaper might report that "the TMX went up 200 points or 2 percent today." When the stock market is doing well, the numbers and percentages go up. When it's doing poorly, they go down. It's exactly like using the temperature to discuss the weather.

The index is divided into ten industries and is further divided into subindustries. Here is a list of the ten main industries:

- Energy
- Financials
- Information technology
- Consumer discretion
- Consumer staples
- Healthcare
- Industrials
- Materials
- Telecommunications
- Utilities

The S&P/TMX 60 Index

Another heavily quoted Canadian stock index is the S&P/TMX 60 Index. This index follows 60 representative Canadian large-company stocks trading on the Toronto Stock Exchange. Some of the companies included in the S&P/TMX Composite Index, such as EnCana, Research In Motion, and the Bank of Montreal, are also tracked by the S&P/TMX 60 Index. While both the Composite and the S&P/TMX 60 Indexes rise and fall daily, the S&P/TMX 60 Index tracks a much narrower range of companies and is less useful for investors who want a general benchmark against which to gauge their own stock's performance.

The Scotia Capital Markets Universe Bond Index

If you're invested in the Canadian bond market, you won't be able to track the performance of your investments using a stock index like the S&P/TMX 60. You have to consult an index designed specifically to track bonds. In Canada, Scotia Capital Markets maintains the best-known bond index.

According to its own information sheets, Scotia Capital Markets would like its index to "reflect performance of the broad 'Canadian Bond Market' in a manner similar to the way the S&P/TMX Composite Index represents the Canadian equity market."

Begun in 1979, the Universe Bond Index comprises almost 1,000 issues, including Government of Canada, provincial, municipal, and corporate bonds. These issues represent a market value of over $650 billion in 2007. You'll find the Scotia Capital Markets Universe Bond Index reported in daily newspapers alongside the major stock indices. The bond index is similarly calculated to reflect both number and percentage changes.

U.S. indices

While the Canadian indices might be most useful to you as an investor, it's also a fact that the American economy and its stock markets are considered the world leaders. Individual investors, businesspeople, financial advisers, and mutual fund managers all keep their eye on the performance of key U.S. indices when assessing their own progress in the market. You're sure to recognize at least one of the following key U.S. indices.

The Standard & Poor's 500

Also called the S&P 500, the Standard & Poor's index has become the dominant benchmark in U.S. investing in recent years. The S&P 500 tracks the performance of 500 stocks, comprising 400 industrial companies, 40 utilities, 20 transportation companies, and 40 financial firms.

The S&P 500 is home to some of the best-known stocks in North America, including U.S.-based Microsoft and Dell. With so much fanfare, the S&P has become the index to beat for many mutual fund managers. Outperforming it is cause for celebration.

The Dow Jones Industrial Average

The Dow Jones Industrial Average (DJIA) tracks the performance of 30 companies that are among the largest companies and some of the most venerable stocks the U.S. stock market has to offer. If you own one of these stocks, such as Exxon or IBM, you'll want to know how your stock is faring compared to the average.

The results of the Dow are reported daily in newspapers across Canada, the United States, and the world, as well as on news and financial Web sites. The results, which tell readers the average performance of the stocks in the index, are reported as both numbers and percentages. If the Dow goes up, your newspaper might report that "the Dow was up 300 points or 3 percent today." When the index goes up, investors are actively buying stocks covered by the index.

The Dow Jones is known all over the world, and serves as a daily report on how well the powerful U.S. economy is doing. After falling behind somewhat in the esteem of some critics for shying away from tracking high-tech stocks, the index has always been updated. While it still tracks the same number of companies — 30, to be exact — that number now includes software giants Intel and Microsoft (even though Intel and Microsoft do not trade on the New York Stock Exchange!) and retail giant Home Depot. Look at the Dow relative to its index peers to get a sense about whether certain slices of the stock market are faring better or worse than others.

The Dow Jones Industrial Average is price-weighted — giving companies with a higher stock price more weight regardless of their size. Because of price-weighting, one company's stock can pull the index up or down significantly, even if that direction doesn't reflect the performance of the majority of the index's stocks. That price-weighting doesn't mean you can ignore the DJIA, which follows the performance of giants such as AT&T and General Electric, but you should understand how the average is determined.

The Nasdaq Composite Index

The Nasdaq is another widely quoted U.S. index. It is sometimes seen as a competitor to the S&P, but the Nasdaq Composite is actually very different. For starters, Nasdaq measures the stock performance of approximately 3,200 companies, more than half of them in the high-tech and biotech arenas, and all of them found in the Nasdaq market. The index includes giant U.S. companies like Apple, Intel, MCI Communications, Cisco, Oracle, Microsoft, and Sun Microsystems.

As a result, the Nasdaq index is a good deal more volatile than, for example, the Dow Jones Industrial Average and, perhaps, the stock market at large. It's also home to some of the bigger success stories of the 1990s, most of which are technology firms. The higher the potential for return an investment has, the more the risk it carries.

Just like the DJIA and the S&P 500, the Nasdaq Composite gives the average performance of the stocks in the index both as numbers and percentages. If the Nasdaq goes up, your newspaper might report that "the Nasdaq was up 70 points or 3 percent today."

The Wilshire 5000

Want a good look at how the overall U.S. stock market is doing? The Wilshire 5000 tracks a huge universe of stocks — in fact, it lists almost every publicly listed stock, including those listed on the New York Stock Exchange, the American Stock Exchange, and the Nasdaq Composite. That's a pretty definitive look at the large-, medium-, and small-company stock markets.

This is not a must-read index, especially on a daily basis, but it is an index investors want to at least know about and have the option of viewing once in a while. It's the largest index going. It gives an investor a broad sense of how the U.S. stock market is faring overall and in which direction stocks are headed. More mutual funds have also started investing in stocks listed in the Wilshire 5000, which gives investors total U.S. stock exposure.

Remembering That Performance Is Relative

Everything is relative, regardless of which investment performances you're measuring. What may have been great performance a year ago may be considered good, bad, or indifferent today, depending on how the particular market you're invested in is doing.

Unless you have evidence of other negative indicators, don't knee-jerk into selling an investment just because its performance lags behind an index one year. You're investing for the long term. What's underperforming its index this year may well bounce back next year.

The trick to using indices is to be able to definitively tell how well the performance of your investments stacks up against that of their peers in the market you're in. With that know-how, you can answer questions like: Is this stock's performance average? Is this mutual fund's performance above average? Is this bond's performance poor?

Looking Rationally at Market Highs and Lows

You're investing hard-earned money, so you want to enjoy a sense of comfort and confidence in your investments' potential to perform as expected *over time*. We emphasize the phrase "over time" because chasing short-term performance can drive you crazy.

Investments can look mighty risky if you track their performance every day. In contrast, risk tends to flatten out a bit if you look at it year to year. In fact, since the late 1920s, few classes of investments have lost money over a ten-year period. Of course, some individual investments have lost money, but the general rule applies: Holding on to investments for a longer period of time will reduce your exposure to losses.

Do you want to avoid undue risk? Invest for the long term — or, at the very least, more than two years. If you need to tap your investments earlier than that, stick to shorter-term cash equivalents, such as money market or balanced mutual funds or guaranteed investment certificates or preferred shares.

Learning how to gauge the market is different from thinking you can predict the market. No one — not even the most savvy investor or investment adviser — knows with any real certainty how well or how poorly the market will fare in the future.

Reaching Your Goals

After you start investing, monitor your progress to ensure you're on track. Make the anniversary of your first investment your day of financial reckoning (or at least that month).

When the day arrives, sit down and take an earnest look at what you're investing in, how much you're investing, whether your goals have shifted or changed completely, and whether you're saving enough (and earning enough on your investments) to reach your goals.

The ultimate measure of your portfolio isn't whether you're beating the benchmarks. It's whether you're reaching your goals. Are you? For example, if you determined at the outset that you need to invest $500 a month and earn an average annual return of 9 percent, are you hitting your goal?

If you're meeting or beating your goals, you're in great shape. If you're not, identify what's wrong. Maybe you're not investing enough. You may have to pay off some bills so you can find more money in your household budget to invest. Or you may find that your RRSP needs greater funding, so you have to increase the percentage of your pay you contribute each week or month.

To ensure your investment plan is a workhorse that's pulling its weight, feed it. As you get raises at work, or come into "found" money — maybe a small inheritance, a bonus at work, or a tax refund — consider investing some or even all of these funds in your portfolio.

Knowing When to Sell

Of course, maybe one or more of your investments isn't performing up to your standards. This kind of letdown happens to the best of us, and you can count on a disappointment more than once or twice in your investment life. When underperformance hits home with one of your investments, take a deep breath and try to figure out what's happening.

Figuring out how long to hold on to an investment that isn't producing any growth is a challenge. You have to first determine what's keeping the investment on the rocks. The following sections offer a look at why an investment may be underperforming.

When you sell a stock, bond, or mutual fund, make sure you invest in a Treasury bill before finding your next growth or dividend-paying investment. A Treasury bill is negotiable debt obligation issued by the federal government (of Canada or the United States) and has a maturity of one year or less. Treasury bills are considered the safe securities available to the Canadian investor.

Is the economy the reason for your investment's slump?

Is the entire market taking its lumps? If so, your investment isn't immune. If one or more sectors of the stock market are taking a licking, consider the impact to your stock, bond, or mutual fund. A sluggish economy, or one that is in retreat, can play havoc with investments. Investments are long-term endeavours. Don't sell just because of an economic downturn. You'll take a loss you might regret.

An economic downturn can create a buying opportunity if it sends the price of stocks spiralling downward.

Is your stock falling behind?

If a stock is struggling, look at the company. Forget about what's happened to date for a moment. If you discovered the company again today, would you buy it? Do some analysis on the company's prospects. Don't let your answer be clouded by negative feelings about the past few months or years. If you bought the stock because you believed the company was well positioned for a turnaround due to new and competitive products or services, sales, profits, or other facets of its financial position, hang on a bit more. The last thing you want to do is take a loss on a stock that may turn around a few days or months after you give it the boot.

At the same time, if you decide you wouldn't buy the stock again today, or if some of the economic reasons that attracted you to the stock in the first place haven't panned out, selling is okay. Don't get married to your investments. Investments are tools; they're not friends. You would get rid of a broken screwdriver, so get rid of broken stocks. Fall in love with your family and your faith, but not with your portfolio. If a prettier stock catches your fancy, and some of your existing holdings have turned ugly, consider a switch.

Is your bond slipping behind?

If a bond is doing poorly, maybe because interest rates have risen (bond prices move in the opposite direction to interest rates), ask yourself what cost you can expect from hanging on to the bond until maturity. Compare that expense with what it will cost you to sell the bond. If interest rates jump to, say, 9 percent, and you're hanging on to a bond paying 4 percent, you might well be better off selling the older issue and buying a new bond. The yield to maturity might be the same, though, so be careful.

Is your mutual fund fumbling?

If your mutual fund isn't performing up to snuff, look at the fund manager's style. If the stock market is growth-oriented and your manager is a value manager who looks for bargains, you may be wise to hang on. Value-style investing passes in and out of favour, and you wouldn't want to miss the upside. Of course, if an inept mutual fund manager is the only reason you can find for the lagging performance, you can sell. Try to wait until a fund's performance has been impaired for at least two years in order to avoid unnecessary losses. Good luck!

Chapter 5

Becoming an Effective Investor

In This Chapter

- Diversifying your investment approach
- Investing regularly
- Finding out what you need to know about taxes

Building an investment plan to realize your financial goals is an exciting journey, but it can also be daunting. Some additional common-sense concepts can make your investing experience more productive and less mysterious. A few tricks of the trade also can help you become a more effective investor by guiding you around some of the pitfalls that trip up even the most earnest and dedicated investors.

Starting and Staying with a Diversified Investment Approach

The goal of diversification is to minimize risk. Instead of putting your eggs in one basket by investing every dime you have in one stock, one bond, or one mutual fund, diversify.

Diversification is a key defensive strategy for having a wide array of investments that ideally move slightly out of step with each other. For example, an investment in an international mutual fund might be doing poorly while an investment in a Canadian equity mutual fund is doing well. By investing in different sectors of the investment markets, you create a balanced portfolio. Parts of that portfolio should zig when other sections zag.

Table 5-1 shows the power of diversification by examining how three different diversified portfolios of money markets, bonds, and stocks can fare over time. The table also gives you a concrete idea of the investments that should go in a portfolio based on your own tolerance for risk. They're also a good way for you to measure whether your own portfolio is diverse enough for your own tolerance for risk or loss.

Table 5-1 Three Models of Diversification

	Lower Risk/ Return Portfolio	*Moderate Risk/ Return Portfolio*	*Higher Risk/ Return Portfolio*
Makeup	20% money markets, 40% bonds, 40% stocks	20% money markets, 30% bonds, 50% stocks	20% money markets, 0% bonds, 80% stocks
Return for best year	22.8%	28.1%	35%
Return for worst year	–6.7%	–13.4%	–19.6%
Average annual return	9%	10.1%	10.9%

Determine the percentage of stocks, bonds, and cash you want in your portfolio. In the stock and bond categories (or mutual funds that invest in these assets), don't load up on any one sector of the economy. Steer clear of the temptation to invest in three technology mutual funds, four Internet stocks, or six junk bonds — even if they're paying more than other investments.

The saying "no pain, no gain" also applies to the investment experience. You can avoid the prospect of experiencing any pain at all by investing only in federally insured Canada Savings Bonds and GICs. The price to be paid for that strategy: You may never lose money in the traditional sense, but you never gain much either, which means you can still fall behind. You also run the risk of falling behind because of inflation, which eat ups about 1 to 3 percent of your purchasing power each year. If you earn only 4 or 5 percent a year on your savings or investments, you'll have a hard time preserving the capital you have, let alone growing it. In addition, don't forget that CSBs and GICs pay interest income, which is fully taxable just like your monthly paycheque. If you're going to invest, make sure you get some tax breaks.

Developing a Dollar Cost Averaging Plan

No one can afford to have an investing plan forgotten or relegated to the back burner. You need to set up a plan for making regular investments. This way, you ensure your money is working for you even if your best intentions are diverted.

Dollar cost averaging is a way to ensure you make fixed investments every month or quarter, regardless of other distractions in your life. Dollar cost averaging is a simple concept: You invest a specified dollar amount each month without concern about the price per share or cost of the bond. The market is fluid — the price of your investment moves up and down — so you end up buying some shares when they're inexpensive, some when they're expensive, and some when they're somewhere in between. Because of the commission cost to buy small amounts of stocks or bonds, dollar cost averaging is better suited for buying no-load mutual funds.

In addition to helping you overcome procrastination about saving for investments, dollar cost averaging can help you sidestep some of the anxiety many first-time investors feel about starting to invest in a market that can seem too overheated or risky. With purchases each month or quarter, you buy shares of your chosen investments regardless of how the market is doing.

Dollar cost averaging isn't statistically the most lucrative way to invest. Because markets rise more often than they decline, you're better off saving up your money and buying stocks, bonds, or mutual funds when they hit rock bottom. However, even the so-called experts never have perfect timing. But dollar cost averaging is the most disciplined and reliable way to invest. Consider this: If you set up a dollar cost averaging plan now, then in 10, 20, or 30 years you'll have invested every month in between and accumulated a pretty penny in the interim. Relax. Have fun. You'll like it.

Most mutual funds let you start out on a dollar cost averaging plan (often called pre-authorized contribution or PAC plans for accounts inside or outside your RRSP) for as little as $50 or $100 a month. The only catch is that you have to sign up to allow the fund to take the money from your chequing account each month. To find out if the funds you're interested in offer the service, look for the information in their prospectuses or call their toll-free numbers.

Investing with Your Eye on Taxes

Unfortunately, with investing, as with just about any other activity that generates income, some gains are taxable. The federal government collects all income tax for itself and on behalf of most provinces. As a rule, provincial income tax is calculated as a percentage of your federal income tax rate.

The fact that you will pay combined federal and provincial income tax on your profitable investments should not deter you from trying to invest successfully. A good investor will always come out ahead in the end. But you should realize now that you will pay taxes on investment income and gains. But remember, if you're paying taxes, it's because you're winning — so don't worry, be happy!

Shelter from the (tax) storm: Tax-free savings account (TFSA)

In the 2008 federal budget, Finance Minister Jim Flaherty announced a new form of registered savings account. Beginning in 2009, Canadian residents 18 years of age and over can make a contribution of up to $5,000 annually to a tax-free savings account (TFSA). Unlike an RRSP, contributions to the account won't be tax deductible, but income, dividends, and gains on investments made within the account won't be taxable.

What sort of investments qualify as a TFSA? In general, you can hold the same types of qualified investments as an RRSP, such as stocks, mutual funds, and exchange-traded funds (ETFs), to name a few.

Although the initial amount you can invest, $5,000, is relatively modest compared to RRSP limits, if you invest the maximum amount to the account each year, your TSFA will grow to be quite substantial. The $5,000 yearly contribution limit will be boosted by $500 increments in 2010 and beyond, and any unused contribution room can be carried forward indefinitely. Additionally, any money taken out in a given year will be added to the following year's contribution room. This creates an opportunity for Canadians to contribute again the equivalent of amounts taken out, in future years. If you need quick access to cash, you won't be penalized with future contribution curtailments.

Here are some other rules pertinent to a TFSA:

- Interest on funds borrowed to invest in a TSFA isn't deductible.
- If an account holder dies, investment income earned in a TFSA after the time of death will cease to be tax-exempt. In this case the assets in the TFSA would be transferrable to the TFSA of the surviving spouse. Your tax adviser can walk you best through this scenario.
- Account holders who cease to become Canadian residents can keep maintaining their TFSA and remain exempt from tax on investment income and withdrawals.

For these and other special rules concerning TFSAs, check out the KPMG Web site (`www.kpmg.ca`), visit your local bank, or review the Canada Revenue Agency (`www.cra-arc.gc.ca/menu-e.html`) rules on TFSAs for more guidance.

Consider the following tax implications for investments outside your RRSP.

Savings accounts

Gains on simple savings accounts and tiered savings accounts are taxed as income. Banks and financial institutions report these gains to the Canada Revenue Agency (CRA), just as all investment gains are reported. One exception, however, is the new tax-free savings account, which we discuss in the sidebar, "Shelter from the (tax) storm."

GICs

The interest you earn on non-RRSP GICs must be declared as taxable income, and will be fully taxed — 100 percent of interest earned is included in taxable income — on an annual basis. If, for example, your GIC is locked in for five years, that means you will pay tax each of those years — even if you haven't yet received any of the interest.

Mutual funds

With mutual funds, you might have to pay tax each year on the interest and capital gains the fund distributes to each of its shareholders. You also have to pay taxes on your own gains when you sell shares — another reason for a long-term, buy-and-hold strategy.

Stocks

With stocks, you don't pay taxes on your gains until you sell your shares — a feature fans of stock investing say is a clear advantage in the long run. The downside, however, is that when you do cash in shares down the road, your tax bracket or the tax rate may have increased.

Some common stocks and all preferred shares pay dividends, which might be taxable. If your dividends come from a Canadian company, you get a treat called the *dividend tax credit*. Dividend-bearing investments from Canadian equities are taxed at a lower rate. That's because dividends represent a corporation's after-tax profits. To avoid double taxation, the federal government provides some tax relief in the form of a dividend tax credit, which reduces the rate at which your dividends from Canadian corporations will be taxed.

Calculating the dividend tax credit is a bit confusing (especially for residents of Quebec, who follow a different formula). For non-Quebec residents, you begin by grossing up (multiply upward) the amount of dividends you've received by 25 percent. Then you calculate federal income tax on that amount. Finally, you subtract the dividend tax credit (which is 13.33 percent of the grossed-up dividend) from the income tax you've calculated. In the end, you'll see that dividends are taxed at a lower rate than regular income. For those who can't stomach the calculations, keep in mind that dividend-paying Canadian corporations will send you a statement showing the grossed-up amount, as well as the dividend tax credit.

Bonds

Price appreciation (if any) on a bond — whether it's a government or corporate bond — is taxable when the bond matures as a capital gain.

The interest you earn on a bond is fully taxable annually. That rule applies even to compounded Canada Savings Bonds, where the interest is reinvested yearly, meaning you'll pay tax on interest you haven't yet received.

Tax-deferred investing with RRSPs

As Canadians, we have a very powerful tax-deferral tool in the form of registered retirement savings plans (RRSPs). Maxing out your contributions to your RRSP really does boil down to a choice of paying yourself or paying the CRA.

As we discuss in Book VI, the benefits of investing within an RRSP are twofold: First, all the contributions you make within your RRSP are tax-deductible — in other words, these contributions, up to the allowable limit, become a deduction from your taxable income at any time you choose. Second, the government defers the tax bill for any gains you make on those investments, be they interest, capital gains, or dividends, until you cash in your RRSP.

Even after you turn 71, the tax-deferral power of your RRSP will keep working for you. How? You will have the opportunity to convert your RRSP into a registered retirement income fund (RRIF) and withdraw your funds over time rather than in a lump sum.

Because interest-bearing investments are fully taxed at your marginal tax rate (the rate at which you are taxed on your last earned dollar each year), many investment advisers suggest these as your first choice to go inside an RRSP. Because capital gains are taxed at a lower rate (only 50 percent of the gain is added to your overall taxable income), these might be investments to keep outside your RRSP.

The price you pay for tapping your retirement accounts early

Do not take money out of your RRSP on a whim — say, when you're changing jobs or feel the need for an extravagant vacation. If you make the withdrawal anyway, the money is considered income and is taxed as such by the CRA at your marginal tax rate. You'll also lose the tax-sheltered earning potential the money bought you inside the plan.

Income tax on RRSP withdrawals is withheld immediately when you take the money out. This way, the government gets its money upfront, rather than waiting for you to file your tax return. This manner of extracting income tax is called a withholding tax, and is based on the amount you withdraw. As of the 2008 tax year, if you take $5,000 out of your RRSP, you'll be charged 10 percent withholding tax (unless you live in Quebec, where you'll have to pay more — 21 percent — because the province levies its own withholding tax). Between $5,001 and $15,000, that tax jumps to 20 percent (30 percent for residents of Quebec), and again to 30 percent for withdrawals over $15,000 (35 percent for residents of Quebec).

Because the withholding tax may not match the amount of tax you actually owe on the money you've withdrawn, you will still have to reckon with the CRA at tax time. Depending on your tax bracket, that will either mean paying more when you file your tax return, or getting a rebate for overpayment.

The CRA lets you borrow money from your RRSP for two specific purposes: a first-time home purchase (through what's called the Home Buyers' Plan or HBP); and post-secondary education (via the Lifelong Learning Plan or LLP). In both cases, the money coming out of your RRSP will not be subject to the withholding tax. However, specific rules govern when you must pay it back.

Before you borrow any money from your RRSP through the HBP or LLP, take into account the loss of tax-sheltered income growth you will suffer because of these withdrawals. In other words, even though you aren't paying any interest on the loan from your RRSP (as opposed to a traditional mortgage or student loan), you still pay indirectly. Depending on the amount and the length of time the money is out of your RRSP, this indirect loss of income growth could ultimately make a traditional bank loan the smarter choice.

Book V

Making Your Investments Work for You

"The first thing we should do is get you two into a good mutual fund. Let me get out the 'Magic 8 Ball' and we'll run some options."

Contents at a Glance

Chapter 1: Buying Mutual Funds 347

Chapter 2: Types of Mutual Funds 373

Chapter 3: The Essentials of Stock Investing 395

Chapter 4: Before You Get Started with Stocks 413

Chapter 5: Buying and Selling Stocks 433

Chapter 6: Investing in Bonds 447

Chapter 7: Screening Mutual Funds Online 459

Chapter 8: Internet Stock Screening 467

Chapter 9: Valuing Bonds Online 475

Chapter 1

Buying Mutual Funds

In This Chapter

- Growing to like discount brokers and choosing the right one for you
- Discovering why banks are the simplest place to buy mutual funds
- Figuring out the different types of advisers and choosing the right one for you
- Checking out the no-load advantage and counting the cost of going direct

Before someone tries to sell you a mutual fund, or before you try to buy one on your own, you first have to decide whether you're a resolute do-it-yourself investor or a person who needs a person. Humanity can be divided into two groups: Those who want help with their investing and those who want to do it on their own. Funds are perfect for either approach. In this chapter, you'll find descriptions of the different companies and people you can go to for advice on selecting funds — or simply to have your purchase and sale orders carried out. You can also read about a few of the advantages and drawbacks of each method of buying and selling funds.

Checking Out Discount Brokers

Discount brokers are about the closest you can get, as yet, to investing heaven — they're cheap and simple. A discount brokerage account is a great place to build wealth for the long term because you can put almost any kind of investment into it — including mutual funds, common stocks, preferred shares, bonds, Treasury bills, term deposits, Canada Savings Bonds, or even your own mortgage. Next to the invention of the mutual fund itself, discount brokers have done more than any other financial innovation to open up the stock and bond markets to ordinary people. And, best of all, discount brokers are reasonably good at keeping costs down, which is one of the most important determinants of investment success. Discounters are firms set up simply to carry out your buy-and-sell orders — charging low commission rates — and to provide an account in which you can hold your investments. They sometimes purport to offer lots of flashy services and information, some of which can actually be useful. But, essentially, a discounter is just a bare-bones order-taking and safekeeping service.

In Canada, a minor price war broke out among discounters in the late 1990s as firms vied to come up with special offers, dancing dogs in neck ruffs, free trades, and extra services — which usually added up to a better deal for customers. Since then, though, the special promotions have died down — discounters have given up expensive gimmicks, sometimes even raised their rates, and concentrated their marketing more narrowly on getting the clients they really want, folks with plenty of cash. Picking a discount broker can be tricky, though. This chapter gives you the whole story — how discounters work, how they can save you more of your hard-earned cash, and how to pick the right one for you.

Discovering what discount brokers are

A discount broker is a true broker in the sense that it's a firm set up simply to act as an agent. It collects a commission — that is, a transaction fee — when you buy or sell stocks, bonds, funds, and other investments. Yes, financial planners, insurance agents, and traditional stockbrokers also take your orders in this way, but they also bill themselves as advisers and experts who get a fee for helping out. Nothing wrong with that as such — but their fees eat into your returns. A Canadian discount brokerage firm is nearly always an arm of a big bank, taking most orders over the phone or the Internet. In the United States, discounters execute your share-buying transactions for as little as US$8. In Canada, minimum charges for a single trade are generally C$25 and up. Discounters are perfect for mutual fund investors, because they sell a huge range of funds with low sales commissions.

If you're absolutely certain you're going to want personal advice from someone when you pick your funds, then skip this part of the chapter and jump ahead to the section "Dealing with Your Friendly Neighbourhood Bank" for details about banks and the services they provide. Discount brokers don't provide much advice, so if you feel you need help picking funds, you won't enjoy using one. In the same way, little or no "financial planning" comes on offer from a discount broker. Just a bare-bones account to hold your investments, and rock-bottom fees to buy and sell. The discounters may offer to sell you fancy packages of preselected funds, but not much personal advice about your situation.

Discounters, then, essentially offer a commodity. They employ a bunch of youngsters who are paid a wage for covering the phone and who don't traditionally get extra pay for persuading customers to buy things. In return for charging low commissions, discounters hope to attract enough business to turn a profit. That's why they're so keen to turn as much of their business as possible over to the Internet, where it can be automated.

In the not-too-distant past, discounters were subject to the provincial securities rule that obliges brokers to ensure trades are suitable for the client. Like other people in the investment business who accept your money, they were supposed to follow the *Know Your Client* rule (the concept that people selling investments should recommend only securities that are suitable for the customer). However, securities regulators in Canada have since begun relaxing the requirement that trades through a discount broker must be vetted to find out whether they fit with the customer's risk tolerance and investment knowledge. That was after lobbying by the discounters, who claimed having a human being check every trade slowed up the process too much. The message, for those who may have missed it, is this: When investing through a discounter, you're on your own, Dennis.

Getting set up with a discounter

Setting up an account with a discount broker is simplicity itself. You don't have to sit through a sales spiel or show you have thousands to invest — just call them up, sign a few forms, open an account, and put in some money. Here are the basic steps:

- Call the discount broker you picked and ask for a new account application form or an RRSP application form. You can usually print it right off the firm's Web site.
- Fill in and sign the form, and send it back.
- Notice the dense pages of conditions they make you sign. Guess what? They're not in your favour. But just about all discount brokers impose these convoluted terms — which essentially say that in the event of a disagreement the broker is always right — so you can't really escape.
- A discounter will pretty well accept your business no matter how poor you are. But you'll have to have the necessary cash in your account, Jack, before you make the first trade. For a fund, the minimum buy is typically $500.
- You never have to meet anyone face to face. The anonymity is relaxing, although you'll almost certainly get put on hold for a good stretch when problems occur in your account. And you'll get used to shouting at dazed teenage brokerage house slaves in a harsh barking tone.
- After that, just phone in your orders and check your account statement carefully. Always have them mail the trade-confirmation slip to you and check it against the order you placed.

Most discounters let you call up your account online, so just take a printout of the page and date it when you want a permanent record of your holdings and their value. They'll also mail you a monthly statement if you place orders, or a quarterly one if you don't. Check these against your own records.

Using a discount broker is investing for grown-ups. No one is around to hold your tiny hand or coo into your tight little rosebud of an ear that "the market always comes back." In return for the low commissions they charge, discounters are geared to provide little or no personal service.

Selecting a discounter

Don't get in a lather comparing the discounters' commissions and totting up their special offers. It's wonderful to see people in the investment business offering to cut their prices, but over the long term saving $100 on a one-off basis doesn't amount to much. If you plan to simply buy and hold high-quality funds and stocks, it doesn't make a lot of difference whether you've spent $100 or $200 in commissions building the portfolio. Yes, cheaper is always better, but fast and polite responses to your orders or questions, and investments that suit your needs, are all just as important as low rates. Get good prices for your investments, too. Saving $100 on your commission isn't worth much if you end up paying $189 more for your investments.

At your service

The important thing is efficient, accurate, and prompt service — something that, sadly, discounters seem to have had a problem providing in the past. After a debacle in the hectic stock market of early 2000, when some clients said they were left on the phone for up to a week, the discount firms embarked on a hiring frenzy aimed at ensuring they had enough staff to handle soaring demand.

If you've got the time and energy, you could pick a firm by opening two or even three separate accounts at different discounters at first — usually no fees apply for signing up as a client. After a year or so, you'll get a good feel for which discounter is most reliable and the easiest to use and you can transfer all your assets there. Be sure to ask your family, friends, and work mates about their experience with discounters. If you keep coming across horror stories about a particular firm, then shop elsewhere.

Apart from commissions, the fee you're most likely to face at a discount broker is an annual administration fee of about $75 to $100 for an RRSP (very often the fee is waived if your account is big enough and you just ask).

Don't worry too much about picking the right discounter. If you make the wrong choice, you can switch later at the cost of a few weeks' wait and a fee of about $100. It's messy — watch out for mistakes while they transfer your investments — but you have a right to move.

Finding the right discounter for you

A very good source of information on discount brokers — and low-cost investing in general — is the Stingy Investor Web site (`www.ndir.com`). Run by avid number-cruncher Norman Rothery of Toronto, it offers a rundown of discounters' rates (although some of the information may be out of date from time to time).

Don't become obsessed with commission rates when choosing a discounter. Some have decided to market themselves as cut-price providers, offering minimum commissions for a stock trade that can run $25 or even less. That's a tremendous deal for investors, but remember that if you don't plan to trade stocks frequently it's of only limited value. Look at the whole picture — including mutual fund commissions, service standards, and special options — before you make your choice.

Try calling the company a couple times with questions. If you can't seem to get decent answers, then consider going somewhere else.

Many experts advise that you should use a discount broker not owned by your usual bank. That way, if ever a dispute occurs over a trade, the broker can't just dip into your bank account and extract money.

How about a mutual fund discount broker?

Apart from the true discount brokers, which are licensed to deal in stocks and bonds as well as funds, investors also can choose from among dozens of "no-load" or "discount" mutual fund dealers that sell only mutual funds. These companies, which are often happy to buy and sell funds over the telephone, usually charge no commission on front-load funds, living off the rich trailer fee instead. The trailer fee is like a storage payment paid to any company where you keep your mutual funds. It's a little behind-the-scene retainer paid for looking after your mutual funds — so make sure you're being looked after. Individual stockbrokers and financial planners also frequently offer to sell funds with no load.

Discount dealers will clearly save you money, and no reason not to go with one exists if you're happy with the level of service available and the selection of funds. But once again, don't let cost be the only deciding factor. No point saving yourself a one-off expense of 2 percent if the dealer subsequently doesn't give you enough advice and choice of products. Stick to a regular discount broker who's able to buy and sell your shares and bonds as well as funds while also offering low commissions. And deal with a discounter that's a large multi-billion-dollar organization so you know the systems are in place to administer your account properly.

Dealing with Your Friendly Neighbourhood Bank

In the mid-1990s, if you asked an executive at a non–bank fund company why the banks didn't seem to be able to run a decent equity fund, he'd have curled his lip with scorn. "How," he would reply, "can the banks expect to get good stock picking out of their wretched nine-to-five wage slaves who ride the commuter cattle trains every morning from suburban wastes north of Toronto?" Well, those days are long gone. Banks have improved the returns from their stock funds and show encouraging signs they are finally reducing the costs charged to mutual fund investors. For one thing, banks have rolled out index funds — which simply track the entire market.

Banks are a great place to buy mutual funds, especially if you just want a simple option that's also an okay value. Perks exist to keeping your investments where you keep your cash. If you use a bank to buy funds, your account statement is on the same record-keeping system as your chequing account, which is very convenient, and no meddlesome, prating salespeople are involved unless you require help, which many investors do. This section shows why you can just go ahead and use your local bank branch for mutual funds if you want a quick solution. You won't get the best bargain going, but it'll do the job.

The good news about buying where you bank

Banks are the very simplest place to buy mutual funds: Just walk in and put your money into a selection of their house brands. But don't assume they're the best choice. A bank is a great place to start out buying funds, but certainly do take a long hard look at what they can and can't offer.

Hey, you're busy, what with training your cat to play the xylophone ("No, the *left* paw!") and getting into the *Guinness Book of Records* for growing the longest nose hairs ever officially recorded (that old fool in Sinkiang-Uighur glued them in). So why not just make things easy on yourself and simply grab your mutual funds at the bank? Mutual fund buyers, especially rookies, can do well at the bank for a number of reasons.

One-stop shopping: Update your passbook and buy a fund

It's easy. Even if you don't have an account with a bank, you can still walk into a branch, hand over a cheque, and sign up. Okay, it may take a couple of days to get an appointment with a registered representative, a bank employee who is licensed to sell funds, but after that the process should be painless. After you've opened a fund account, you can use the services most banks have for buying and selling funds — nearly all offer telephone and Internet options that let you check your account balance and recent transactions, and transfer funds between your bank accounts and investment accounts.

Banks sell their own funds with no commissions or sales loads. That means all your money goes to work for you right away, and you can cash out at any time with no penalty (although some banks and other fund companies impose a short-term trading penalty, typically 2 percent, on those who sell a fund within 90 days).

You can set up a fairly decent mutual fund RRSP — a tax-sheltered account of retirement money — at a bank in a half-hour flat by simply buying one of their preselected fund packages. Staff are trained to sell these mixtures, and questionnaires are designed to slot you into the right one, so you're likely to get a reasonable fit.

Keeping it together: All your eggs in one basket

Now that the banks have taken a healthy bite into the trust industry, you probably have your mortgage, line of credit, and chequing account at a bank. So buying mutual funds from the company that already holds the mortgage on your house means you get the luxury of dealing with the same bank employee for everything.

Offering to move your mutual fund business to a bank can radically improve your bargaining power when seeking a loan or mortgage. Bank employees get little chocolate soccer balls as rewards when their customers bring their investment portfolios to the branch. Use this to your advantage when looking to extend your credit, take a plunge into the real estate market, or buy a car. In today's competitive banking environment, an investor with a portfolio is a sought-after prize.

Not just a watering hole in the Namib Desert

The employees you deal with at a bank branch get wages, so they're not commission-driven jackals. But they usually sell only the house brand. And yes, they receive incentives to attract business, and yes, the banks tend to be vague on exactly what bonuses are paid.

For the most part, you'll find that banks are happy to sell you index funds — low-expense funds that simply track the stock- or bond-market index or benchmark. Index funds are such a good deal they should probably be part of every investor's arsenal, although you could consider having between one-third and one-half of your stock market investments in traditional actively managed funds, featuring a person who buys and sells investments in search of trading profits.

Banks, unlike mutual fund companies that market their products through commission-paid salespeople, are able to make money from running index funds because they don't have to pay out those big commissions. Most offer index funds with expenses as low as 1 percent, compared with 2.6 percent on the average Canadian equity fund, for example. If you were to simply walk into a branch and open up a mutual fund account full of index funds like that, chances are you'd do better than millions of mutual fund investors — although they would be making money too.

Banks fight for the right to serve you

The banks are hungry for your mutual fund business and they're willing to cut prices and improve service to get it. The fantastic growth of the Canadian mutual fund industry, with assets soaring to more than $684 billion in mid-2008 from less than $30 billion in 1990, has represented a migration of cash from bank savings accounts and guaranteed investment certificates into funds. The banks want to hold on to as much of that money as they can.

Another reason why the banks are fund-mad is that mutual funds are a wonderfully profitable and low-risk business. The management company just keeps raking off those 2-percent fees (plus expenses), no matter how well or badly the fund does. That must be a great comfort to unitholders of the average U.S. large-cap growth stock fund, for example, who lost an average of 19.1 percent of their money annually in the three bear years ending July 2003. Even large-cap value funds, the sort that Warren Buffett may hold, lost 1.98 percent annually during this dreadful three-year period according to Morningstar.com.

If you own managed mutual funds or index funds, then you're going to be paying invisible fees. The best revenge is to also own shares of the bank or the mutual fund company — if they're publicly traded on a stock exchange. If you drink milk, own a piece of the cow!

Lending money, the banks' traditional way of making a profit, is more risky than selling mutual funds because borrowers can default and interest rates can jump, leaving the banks stuck with a pile of underpriced loans. So, more and more, banks are trying to become "wealth management" companies, and mutual funds are the name of that ballgame.

Buyer beware: Banking cons

Nobody's perfect, and buying funds at a bank — either over the telephone or by going into a branch — has its drawbacks. Here, for your viewing pleasure, are the drawbacks of lining the pockets of nasal power-hungry guys from New Brunswick, the sort who become bank chairmen.

Few options

The big problem is lack of choice: The banks have dragged their feet on marketing other companies' funds because a banker likes sharing fees like a lobster enjoys taking a hot bath. That means customers are often stuck with the bank's line of products, which isn't always the strongest. More and more bank employees have personal finance training, but most aren't specialists in the field. To get a full analysis of your situation, you may still have to go to a planner or an investment adviser working for an independent firm.

The narrow selection of funds at many branches is the biggest problem with buying from a bank. All the big banks offer a full range of funds under their own brand name, but that doesn't necessarily mean their Canadian equity or global equity funds will be any good. And even if you try to build a diversified fund portfolio by buying the bank's index funds and actively managed funds as well, you always risk leaving too much money with just one investment team. Suppose a particular coterie usually tends to get excited about flashy technology stocks — then you're likely to lose money when other investors get tired of such high-priced science fiction tales. You can get around this lack of diversification — the annoying word for spreading out your investments — by opening an account elsewhere as well, perhaps with another bank. Or you can at least increase your diversification by buying several of the bank's actively managed funds.

Overworked and underpaid: Not just you, some bankers too

Banks are busily blitzing their branch networks and cutting back on staff in search of higher profits, so it's getting harder and harder to talk to an actual human being unless you've got a whopping balance in your account. That's a drag and it's a disadvantage of going to a bank if you'd rather deal with a person than peck at the keyboard of a machine (what's wrong with you, anyway?).

Lack of pressure to perform

Customers who buy funds from a bank are isolated in the sense that the fund managers don't have brokers and other salespeople breathing in a damp, hot way down their necks, insisting on good returns. If a broker-sold fund's performance goes into the tank, salespeople get angry and embarrassed, because they have to face the clients they put into the loser. That's never a fun session. The sales force demands explanations from the manager. So the presence of salespeople probably serves to impose some discipline on fund companies. With bank funds where no brokers are involved, terrible performance used to drag on for years with little publicity or outcry.

Banks now take funds more seriously, meaning that problems get fixed fairly quickly, but bank fund unitholders arguably still don't have anyone looking out for their interests. Yes, nearly all mutual funds have "trustees" who theoretically are on the side of investors, but you won't find many fund trustees saying a single critical word about a fund's management or expenses. Most unitholders wouldn't know where to look for the trustees' names. No wonder — the fund companies hardly ever publicize their identities. You have to plow through the obscure "annual information form" for the fund, available on demand from your fund company, to identify the trustees. Securities cops are pushing to have the system fixed, but the fund companies are in no huge hurry to change the rules.

Another problem with buying funds from your bank is that, well, you're forced to deal with a bank. Phone calls get routed to voice-mail hell before they end up in the bottomless pit of general delivery. Branches are being shuttered across the country, forcing customers to dial 1-800-PLS-HOLD or go to an Internet site (which saves the bank a packet). With all the branch cutbacks, employees are overworked. And they usually have to deal with all the other services and products the bank delivers, and then face the whining, puking, and foot-stamping at home — not to mention the kids. So you won't get the sort of personal attention and time that a good financial planner or even stockbroker delivers. After all, you are getting what you pay for.

Stockbrokers, Financial Planners, and Advisers Aplenty

We may run out of water, out of brain surgeons, out of Vancouver Island marmots, and out of braying self-important financial journalists. But we'll never run out of mutual fund salespeople. Almost 71,000 Canadians hold themselves out as financial advisers or planners in one way or another, and most of them are licensed to sell you mutual funds. They come in a bewildering range of guises, from DKNY-clad smoothies in the downtown core of big cities to hoser types in Molson sweatshirts wolfing down the free sandwiches at fund company lunches. And they give themselves a galaxy of names: financial consultant, investment counsellor, estate planner, financial adviser, investment executive, personal financial planner. Don't get worked up trying to figure out the differences among them. The fact is that the provinces' regulation of the financial planning game is still very spotty, and hampered by power struggles among the competing groups, so that outside Quebec just about anybody is free to call themselves anything.

The ideal situation is to do business with a qualified and experienced investment adviser whom you have grown to trust — someone who enables you to do some discount trading every year and who has financial planning skills that come for free. Having a one-stop shop for stocks, bonds, mutual funds, Treasury bills, RRSPs, RESPs, insurance, and other tax shelters can be very convenient. But, until you meet this special person, you may be better off doing it yourself.

This section describes the main types of fund salespeople and tells you about the advantages of using financial planners who charge only an upfront fee rather than collect commissions on the products they sell you, wrapping up with some basic tips on the right and the wrong ways to pick an adviser.

Commissioned advisers

The vast majority of Canadians choose to go with a financial adviser who gets paid by a mutual fund company or insurance company for selling investment "products." In part, that seems to be a reflection of the nation's thrifty Scottish psyche: Unlike many Americans, Canadians would much rather have the expense of investing advice hidden from them, buried in the fee of a mutual fund or the cost of insurance. That way, it seems so much less painful than having to cut the adviser a cheque.

An obvious example of a commission-paid salesperson is the traditional stockbroker, who makes money when you buy stocks, bonds, or funds. The broker gets a transaction fee or commission each time you put an order through.

- With stocks, the commission is added onto the cost when you buy, or is deducted from the proceeds when you sell — and your transaction confirmation should clearly show how much was charged. For example, when you buy or sell $10,000 worth of shares, you can expect to pay a sales commission of about $300.
- With bonds, the "commission" is normally a profit hidden in the price, just like buying a pair of jeans at the Gap. That's because brokers usually sell bonds to their clients that they already own themselves. No separate commission is charged or shown on your confirmation slip because the broker has already taken a markup.
- With funds, things get more complicated. But the essence of the system is that the broker (or financial planner or insurance salesperson) is paid by the fund company. The fund company, remember, charges an annual management fee — which is deducted from the assets of the fund — and pays roughly half of that out to the salesperson.

Commission-paid salespeople also include life insurance salespeople, whether independent or tied to a particular insurance company. In addition to life insurance, these agents are often licensed to sell mutual funds or the insurance industry's version of mutual funds, which are known as segregated funds. Segregated funds — so-called because their assets must be kept separate from those of the insurance company — carry guarantees to refund up to 100 percent of an investor's initial outlay.

The final group comprises Canada's thousands of financial planners — either in franchises, chains of stores, or small independent offices — whose bread and butter is the mutual fund.

Fee-charging advisers

The next group is far smaller but represents an excellent choice for those who don't mind signing a cheque to get advice. They're the fee-charging financial planners who aren't interested in selling products. In some cases, they'll help you to set up an account at a discount brokerage in which you can buy low-cost funds.

The drawback of going with a fee-charging planner is the pain of paying the freight, which can be substantial. It might be a percentage of your investments — typically 1 or 2 percent — or it might be an hourly charge that ranges from $50 an hour to a few hundred, depending on the complexity of your affairs.

With a fee-charging planner, you may have to make more choices about the investments you buy and the strategy you adopt. That's because the financial plan produced for each client is different, reflecting individual needs and wants, whereas commission-paid salespeople are often happiest suggesting a predesigned and relatively fixed package of funds that leaves you with few decisions to make.

Investors with substantial assets, in the hundreds of thousands of dollars, should strongly consider going with a fee-charging planner. Your accountant or lawyer may offer the service or may be willing to recommend someone. The fee will often run into several hundred dollars, but that can be a bargain compared with the hidden cost of high mutual fund management fees levied by fund companies that sell through commissioned advisers.

A fee-based planner may produce a plan and then refer you to a commission-charging dealer — or even collect commissions on funds you buy. That kind of double-charging adds another layer of complexity and fees, and it might not be the best deal for you. If the adviser is simply putting you into funds that pay commissions to salespeople, then what did you pay the advice fee for?

Salaried advisers

Thousands of financial advisers are being trained by the banks to take over the "wealth-management" needs of the aging baby boomers. They're generally on salary — plus bonuses if they can persuade you to put your savings into one of the bank's products, usually mutual funds or some other kind of managed-money program.

As explained earlier in this chapter, these bank employees are often limited in the products they can offer, and their training may not be as full as that of brokers or specialized financial planners. That means their advice should always be taken with a pinch of salt: they're employed to push the bank's products or sell funds that pay the bank a fat commission. Still, especially for investors with relatively simple needs and clear financial goals, the bank can be a great place to start off investing. Compared with the hard-driving world of stockbrokers or financial planners, little sales pressure occurs. The product choices are simple, and having all your money in one place makes for easy record keeping.

But don't forget you're doing the bank a favour by handing over your savings. That means you're entitled to advice from a helpful and experienced bank employee, not some rookie or sleepyhead. And don't get railroaded into buying one of the fixed arrangements of funds or so-called wrap accounts the banks love to pitch (it makes their administration much easier, for one thing). If you feel that none of the preselected packages meets your needs, then insist on a custom mixture of funds.

In general, the bank is the perfect first stop for starting-out investors with only a few thousand dollars at their disposal. The banks are equipped to deal with small accounts and they have handy automated systems that allow you to check your account balance and transactions without waiting for someone to get back to you.

Banks' training programs are getting better all the time as the wealth-management business becomes vital to their future profit growth. Some banks even have qualified brokers available right in the branch who can sell you a range of stocks and bonds and funds from nearly every company.

The blurred distinctions among all these types of commission-paid advisers make the whole business of looking for help confusing. But at least you have one thing going for you: Remember that if you buy mutual funds, your money is in good safekeeping because it goes to the fund company instead of staying with the broker or dealer. So if you decide to dump your salesperson and his or her firm, you can simply shift the account elsewhere, after some whining and delays on the part of the old salesperson. Your money is doubly safe because even the fund company itself has to leave the fund's assets with a separate custodian for safekeeping. Good safekeeping doesn't make your mutual fund immune from going up and down in value.

Make sure you'll be receiving a statement at least twice a year from the fund company (ask to see a sample) so you can be certain you're on the company's books. And make your cheque out to the fund company, not the salesperson. Finally, get transaction confirmations for your purchases from the company — alternatively, you can call the fund company itself to double-check they have a record of your investment.

Finding the right professional

To fix yourself up with a well-trained and professional planner, make sure he or she meets one or more of the following tests:

- **Membership in Advocis:** Advocis is Canada's largest association of financial advisers. It represents thousands of professional advisers and has members in 50 chapters across the country. Advocis members are to adhere to a strict Code of Professional Conduct, meet ongoing continuing education requirements, and commit to putting the interests of their clients first. Making life simpler for investors, two former financial planning groups — the Canadian Association of Financial Planners and the Canadian Association of Insurance and Financial Advisors — merged in September 2002 to create Advocis, the brand name of the Financial Advisors Association of Canada (`www.advocis.ca`).
- **Completion of a recognized industry course:** These include courses that lead to the Certified Financial Planner (CFP) and Registered Financial Planner (RFP) designations. The CFP designation is administered and overseen by the Financial Planners Standards Council (FPSC). CFP licensees must meet the Council's standards in education, experience, examination, and ethics. Continuing education is required. The RFP designation used to be awarded by the Canadian Association of Financial Planners (CAFP), which merged into Advocis. The RFP program is now phased out. The Advocis Web site lays out how the different designations merged into a more streamlined form.
- **Certified General Accountant (CGA):** An accounting designation granted to individuals who have fulfilled the educational and experience requirements of their provincial governing body. CGAs are trained in tax, accounting, and financial management. They are required to abide by a code of conduct and participate in a mandatory continuing education program.
- **Certified Management Accountant (CMA):** A person who passed the requirements of his or her provincial society of management accountants. CMAs are financial management professionals who combine accounting and strategic business management skills. They adhere to a strict code of conduct.

- **Chartered Accountant (CA):** Someone who has passed the national Uniform Final Exam. CAs have extensive training in tax and other areas of financial management and must also adhere to a code of conduct.
- **Employment by a chartered bank or by an investment dealer that is a member of the Investment Industry Regulatory Organization of Canada (IIROC):** If the person works for a bank, you can be sure of some supervision — but take nothing for granted. The banks have set up their own personal finance training system, but no guarantee exists that the person you get is particularly knowledgeable. If the adviser works for an IIROC investment firm, he or she could be incompetent or greedy, but at least you know he or she has passed the Canadian Securities Course, the educational course given to all new stockbrokers. (Members of the public are also welcome to take this excellent course, virtually all of which has been useful to financial reporters and investors. Call the Canadian Securities Institute at 416-364-9130 in Toronto or dial toll-free 1-866-866-2601 (English) or 1-866-866-2602 (French). The Web site is `www.csi.ca`. The IIROC is a lobby group and disciplinary body for investment advisers. If the person who wants to sell you mutual funds doesn't work for an IIROC firm, then his or her employer should be in the new Mutual Fund Dealers Association of Canada — which was set up to catch mutual fund dealers who "fall through the cracks" with no industry-run body to keep an eye on them.

Unfortunately, you can easily come across bad planners, brokers, and advisers who have impressive qualifications or reputable employers. But at least you know that if they've gone to the trouble of getting trained, or they're under some kind of supervision from a large organization, then you're less likely to be stuck with a complete turkey.

The right way to pick an adviser

Finding an adviser is very like picking a building contractor or nanny: word of mouth and your own gut instincts are among the best methods to use. So your first move should be to ask friends and relatives what they've done and whether they're happy with their advisers. And then go to see several candidates. Apart from qualifications and membership in a professional association, check out the following things.

Does the adviser seem curious about you and willing to answer questions frankly?

A good adviser will ask you questions about your income, life history, assets, financial goals, health, marital status, pension, and investment knowledge. If that doesn't happen, then you could be dealing with a sales-driven hotshot who's just looking to make commissions quickly. Shop elsewhere. And ask about sales commissions as well as the adviser's experience and training. Vague answers are a bad sign.

Does the adviser work for a firm with an adequate back office for client record keeping and supervision?

Jargon alert — having an adequate "back office" or securities department is just a fancy way of saying the firm is set up to administer clients' accounts and orders. Ask to see a typical client statement, and ensure the firm has a *compliance officer,* an employee who keeps an eye on the salespeople and the way they treat clients.

Does the adviser sell a broad range of products?

A planner who wants to talk about funds from just one or two companies is probably lazy. Nobody can be familiar with the products from every company, but you want someone with a good idea of what's out there. You also want an adviser who's knowledgeable about life insurance, or who can at least hook you up with an insurance expert.

Are the adviser's office, grooming, and general image professional?

Nobody's looking for Armani or marble halls, but sloppy-looking premises or a scruffy appearance are signs of someone who hasn't been able to attract many clients.

The wrong way to pick an adviser

Unfortunately, a lot of what passes for investor education is just a giant sales pitch. So-called "seminars" that purport to enlighten you on a particular topic such as preparing a will or taking early retirement are really just a way of getting lots of sales targets into a room. Wandering around a glitzy "exhibition" or "forum" for investors may be fun and even informative. But these events are also a lure for getting "prospects" — potential customers — into a nice concentrated bunch where they can be picked off easily. In fact, be careful about attending seminars if you're the excitable or gullible type. The colourful celebrity speakers who work the investment circuit are often masters of making their audience both greedy and afraid — easy targets for the inevitable sales spiel from the salespeople who paid for the event.

If the phone rings with a broker, adviser, or planner offering to help, decline politely and hang up. Always. Such "cold calls" are a time-honoured method of drumming up business for brokers, and the salesperson calling may be perfectly legitimate. But responding to a random phone call out of the blue is an awful way of picking someone who's supposed to help you manage your money — such an important aspect of your life. You wouldn't choose a doctor this way.

The telephone is still a favourite tool of those creatures that occasionally crawl out from under the rocks — the dishonest salespeople pushing "unlisted" and "over-the-counter" stocks or other "unregistered" investments that promise fantastic returns. Do yourself a favour and have some fun. Rent two wonderful movies about these crooked sales reptiles: *Glengarry Glen Ross,* based on David Mamet's play about sleazy real estate marketers, and *Boiler Room,* a movie released in 2000 that tells the tale of some Long Island junk-stock pushers. After watching those two great films, you'll be better equipped to deal with telephone sales pitches.

Buying Direct

Buying your mutual funds directly from a fund company instead of from a bank or through an adviser is one of the more enjoyable and profitable ways of investing in funds. The company is directly answerable to you when you call or e-mail, and you can pull your money out with no strings attached if the managers don't make the fund go up. And best of all: You'll have no sales charges or *loads* to increase your expenses — companies that sell directly to the public without imposing sales commissions are called *no-load* fund marketers. This section examines buying direct, going through the pros and cons of this style of investing and taking you through a list of the top no-load players.

Getting started is easy — just call the companies or company you're interested in. They'll be pleased to send you the information about their funds. Table 1-1 lists the Web site addresses and assets of the biggest no-load fund companies on the Canadian scene. All are independent companies except for the big Altamira Financial Services Inc., which was bought during 2002 by National Bank of Canada. No-load fund managers treat you rather like discount brokers do. They have dozens of telephone-answering staff who will handle your orders but don't know much about you. All you have to do to invest is call their toll-free number and transfer some money or send a cheque. No wheedling, pawing salesperson exists in the shape of a broker, planner, or insurance agent, which means no fiddly and costly commissions to worry about. No-load companies are generally fairly big businesses and they can usually be relied on to send pretty reliable statements of your account. Sounds perfect, doesn't it? But first up, you have to make a choice between these two alternatives:

- The no-load direct sellers that offer truly low expenses but also come with a narrow selection and higher minimum investment
- Altamira, with its wonderfully wide selection and low initial investment but higher expenses (which are in line with mutual fund industry averages)

Table 1-1 No-Load Direct Sellers in Canada

Company	*Web Site*	*Assets (in $ thousands, as of mid-2008)*
Altamira Financial Services	www.altamira.com	4,060,000
Mawer Investment Management	www.mawer.com	5,000,000
Sceptre Investment Counsel	www.sceptre.ca	9,000,000
Saxon Group of Funds	www.saxonfunds.com	4,500,000

The advantages of buying direct

A no-load company that sells to the public is a halfway house between the lonely course of picking your own funds at a discount broker on the one hand and the comfy warm blanket of getting help from a bank employee or a salesperson who earns commissions on the other. When you go to such a salesperson (the option explored in "Stockbrokers, Financial Planners, and Advisers Aplenty" in this chapter) or a bank (see "Dealing with Your Friendly Neighbourhood Bank" in this chapter), you get lots of assistance — but you usually pay for the advice in the form of higher annual costs imposed on your fund. And the selection a bank or commission-paid salesperson carries is often limited to only a few dozen funds. At a no-load company, the people answering the phone will offer some advice and the expenses on their funds may be low. But the selection of funds on offer is once again limited to the company's own products, and that might be just a handful of funds. Discount brokers (see "Checking Out Discount Brokers" in this chapter), whoopee, have lots of funds. They're the amusement park of funds. But you'll be riding that roller coaster alone, because you'll get hardly any help.

When you contact any fund company, no matter how it sells its products, ignore all of the marketing blather and ask for an application form and prospectus. Those two usually set out the stuff you need to know, such as minimum investment and annual costs. You can always slip 'em in the recycling bin later. Or toss them in that old rusty oil drum you use to burn garbage. (Don't the people next door complain about the choking greasy plume of smoke, by the way?)

Important advantages to going with a no-load direct fund seller exist if you want a hassle-free solution. Here are the main ones.

More money in your pocket

The biggest plus of buying from a no-load company is the fact that you cut out the intermediary. No-load companies can charge you lower fees — although they don't always choose to do so. Because they don't have to pay an army of brokers — or cover the expense of running a sprawling network of bank branches — some direct sellers offer Canadian stock funds with annual expenses of 1.5 percent or less. That's much cheaper than most domestic equity mutual funds, which have total annual costs and fees closer to 2.5 percent. The more expensive fund is taking an extra 1 percent annually out of your mottled hide — over ten years, that difference adds up to 10 percent of your money.

Why one percentage point matters to you

If you were to invest $10,000 and earn a tax-free average annual return of 9 percent for a decade, you'd end up with $23,674. But the same $10,000 invested at a 10-percent rate of return, because the expenses were one percentage point lower, would grow to $25,937 — more than $2,200 more (see Table 1-2). That's why it's better to have a fund with a 1.5-percent annual expense ratio, rather than one with 2.5 percent in annual expenses. You can check a fund's expenses at *The Globe and Mail*'s mutual fund site, `www.globefund.com`, or look at your newspaper's monthly fund report.

Table 1-2 Think 1 Percent Doesn't Matter? That'll Be $2,263, Please

Year	*Value at 9-Percent Return*	*Value at 10-Percent Return*
Initial investment	$10,000	$10,000
1st	$10,900	$11,000
2nd	$11,881	$12,100
3rd	$12,950	$13,310
4th	$14,116	$14,641
5th	$15,386	$16,105
6th	$16,771	$17,716
7th	$18,280	$19,487
8th	$19,926	$21,436
9th	$21,719	$23,579
10th	$23,674	$25,937

Advice for adults

Another advantage of going directly to a fund company is that you're treated like an adult rather than simply as a faceless consumer of the fund product. In other words, the company's Web site and mailings to investors often are more candid about performance. That's because many of the investors who use no-load companies tend to be independent souls who relish the low costs and are happy with the lower level of advice. They're the sort to demand complete reporting of performance.

If you're not satisfied with the performance of your no-load funds, or if you have queries, it's simple to just pick up the phone and call. You may not get the errant fund manager or a senior executive, but the representative who answers the phone will probably be able to give you some answers.

And best of all, buying no-load doesn't mean you have to give up getting advice altogether. Direct sellers often have staff who can advise you on choosing funds and even help you shape your overall investment strategy.

Make mine simple

Dealing with a fund company directly is simpler than buying a fund through a salesperson. You're not forced to relay your order or request via someone else, potentially causing confusion or delay. You can call up the company and buy and sell funds in your account right over the phone or the Internet as well as asking for forms or other administrative help. Your relationship as a customer is clearly with the fund company, not with an intermediary like a broker. That's great for you because:

- You have just one company to deal with and complain to if a mistake occurs in your account. Or did you say you enjoyed muttering endlessly into voice mail, like a doomed character in an abandoned Samuel Beckett play?
- You get just one annual and quarterly statement of account.
- If you own several funds, it's handy to be able to check on their performance if they're all included in one company's mailings.
- You can switch money easily from fund to fund as your needs or assets change.

Allowing frequent trades

It's often tempting to move your money frequently from fund to fund in an attempt to catch rising stock markets and avoid falling ones. Naturally, frequent traders love using no-load companies because no charges apply to switch their money in and out. That makes a no-load fund company the perfect choice if you fancy yourself someone with the ability to time movements

in stock, bond, Treasury bill, and foreign exchange prices — for example, every time the Canadian stock market goes up 20 percent in a year, you might decide to pull out of stocks. But no-load fund companies don't appreciate it when customers move their money around constantly, because it increases the company's administration costs (all of those transfers must be accounted for). So they'll eventually crack down on you by limiting your trades. And you'll often get slapped with a charge of 2 percent of your money if you switch out of a fund within three months of buying it.

Still, if you want to try to outguess the markets and trade some money around every few months (even though it's often a bad idea), then direct and no-load may be the way to go. Here's why:

- The companies have people on staff to move your money from fund to fund quickly and easily.
- No sales charges complicate the transfer of money or add to your costs.
- Buying and selling the fund directly from the no-load fund company rather than through a discount broker or commission-paid adviser means your purchase and sale orders go directly into the fund company's system instead of through a discount brokerage employee. That speeds up the process and reduces the probability of mistakes in your order.
- You get an account statement and transaction confirmation slip in the mail directly from the no-load company and not through the discounter. That's simpler and more convenient for investors who are closely tracking their own performance.

Switching into and out of no-load funds through a discount broker can in fact cost you commissions, because discounters often impose small fees of around $35 each time you sell a no-load fund. A conventional broker might not welcome your business if you plan to chop and change your portfolio all the time, because of all the troublesome paperwork you create. Heavy and constant trading won't thrill even a no-load fund company. That's because trading raises administrative and mailing costs, which have to be paid by other investors. So with many companies, expect to pay a 2-percent penalty when you move money out of a fund within three months of buying it. And if you really go over the top, you may be banned from switching your money around or limited to a certain number of trades — say, one a month. How many trades are too many trades? No firm rules exist on what counts as heavy trading, but we offer a few guidelines:

- An investor who moves some of his or her money from fund to fund twice a year or less would count as a light or infrequent trader.

- Someone who makes between 2 and 12 trades a year would count as a medium trader.
- More than a dozen trades a year indicates the investor is a heavy trader who thinks he or she can outguess the market.

A fund company is unlikely to cut off your buying and selling privileges unless you're trading very frequently — making changes to your portfolio every few days or every week. If you do get cut off and you can't resolve the situation, you may have to move your money to a discount broker that allows constant trading. But even if you buy through a discounter, the funds you're buying may well levy that 2-percent penalty if you sell a holding that was bought fewer than three months ago.

The penalty seems small but it reduces your return. Suppose you decide the Canadian stock market is set to boom because oil prices are rising (foreign investors see us as resource producers in toques, so they tend to buy into our market when prices for commodities, such as lumber, energy, and metals, are going up). You put $10,000 into a no-load company's Canadian equity fund, a fund that invests in stocks and shares (which in turn are a tiny slice of ownership of companies). The Canadian market goes up 10 percent in two weeks and your fund matches the rise in the broad market, boosting your investment to $11,000 — at which point you sell half of your holding in the fund, or $5,500. If the company slaps a 2-percent fee on investors who leave a fund after fewer than 90 days then you'll have just $5,390, which is $5,500 minus 2 percent. Of course, your other $5,500 is still sitting in the fund.

How many trades are too many? Well, research seems to show that almost any level of chopping and changing reduces overall returns because most investors let emotion distort their judgment, leading them to do things at the wrong time. People sell when the market has slumped and is about to bounce back. And they buy after it has already shot up and is about to go on the slide. Getting some sound investment advice — not to mention discounted trading privileges — from a financial adviser might not be such a bad idea after all. (Refer to "Stockbrokers, Financial Planners, and Advisers Aplenty" for more.)

Over time, share prices may tend to rise remorselessly as good companies thrive and the world economy grows, but the stock market also advances in sudden starts. If, following the dictates of your brilliant can't-lose trading strategy, you happen to have sold your equity funds just before one of those days, then you miss out on the profits. That said, sometimes moving money out of a fund is a sensible idea, and holding the fund directly at a no-load company makes the process easier. Good times to move money include:

- When the fund has gone up so much that it now represents a huge portion of your portfolio. For example, if you've decided to keep just half of your money in shares, but one or more of your equity funds have produced a 100-percent return over the past year, then you probably have too much money riding on equities. Time to sell some of those stock funds.
- If you're foolhardy enough to bet on a *specialty* fund that invests in just one narrow section of the market, such as South Korea or financial-services shares, and you've been lucky enough to score a big profit. Such one-flavour funds tend to post huge crashes soon after their big wins — as investors go cool on the kind of stocks they hold. So think strongly about selling at least some of your units in a specialty fund as soon as it has a good year. No, don't just think about it: Pick up the phone and do it immediately. You can always buy back if the price does fall.
- If your reason for holding the fund no longer applies. For example, a fund manager you like may have quit, or the fund may have changed its investment style.

Check your portfolio once or twice a year, and if it's out of line with your ideal mix of investments, then readjust it by moving money from one fund to another. For example, say you've decided you want one-third of your $10,000 mutual fund collection in sure-and-steady government bonds — certificates issued by the government that pay interest and can be cashed in again at the issue price after a set number of years. The other two-thirds is in lucrative-but-dangerous stocks, those tiny pieces of ownership in companies. See Chapters 3 and 6 for more on stocks and bonds.

So your setup is:

$3,300 bond funds	33 percent of portfolio
$6,700 stock funds	67 percent of portfolio
$10,000 total portfolio	100 percent of portfolio

Say the bonds hold their value over the next year, remaining at $3,300, but the stocks rise 30 percent to $8,710, which gives you a mix of:

$3,300 bond funds	27 percent of portfolio
$8,710 stock funds	73 percent of portfolio
$12,010 total portfolio	100 percent of portfolio

This means you have too much riding on the stock market in relation to your original plan — almost three-quarters of the total pile. You can fix it easily by

moving $663 out of your stock funds and into the bond funds, leaving you with a portfolio that looks like this:

$3,963 bond funds	33 percent of portfolio
$8,047 stock funds	67 percent of portfolio
$12,010 total portfolio	100 percent of portfolio

If you hold a super-volatile fund that invests in a narrow sector or region, such as technology companies or Latin America, it's a good strategy to move some money out of the fund if it shoots up in value. That way, you lock some profits before the probable crash. Holding such funds forever might be of dubious benefit because they're at risk of losing money for long periods.

The drawbacks of buying direct

Most no-load mutual fund companies offer too few funds to really give you a diversified portfolio — that means an account with many different types of investment. Here are the main drawbacks to using a direct seller.

Requires significant levels of cash

As mentioned at the start of this section, not everyone can go direct. As attractive as it seems to investors who are serious minimalists in terms of their need for guidance and their interest in paying fees to invest, you need a minimum amount of cash to play. This is obviously not the case with novice investors, or those in the process of building their portfolio. Although this type of investing may not be the right choice for you now, it is something to keep an eye on as your investing savvy and your portfolio grow.

Offers lack of choice

The main problem with direct purchase of funds is the narrow selection. Few direct sellers have more than one or two funds, so if you leave all your money with the company, you're at risk of seeing the market turn against that particular investment style.

A typical no-load fund company sells just a couple funds of each type. Generally, there'll be

- One or two stock funds
- One or two bond funds
- One or two global equity funds
- Perhaps a few specialty funds, such as one that buys only U.S. stocks

That's a small selection compared to buying from a broker, insurance salesperson, or financial planner, who can often sell you at least a dozen funds in each category. At a discount broker, you can buy hundreds of each.

You can avoid this lack-of-choice drawback by buying the direct seller's funds through a discount broker instead, if they're available. That lets you use the no-load seller's funds, with their nice low expenses, in combination with index funds or funds from other companies. However, your discount broker may not even carry a low-expense company's funds (because the discounter gets little or nothing in sales commissions or trailer fees).

Chapter 2

Types of Mutual Funds

In This Chapter

- Making good money with equity funds
- Using balanced funds as a wonderfully simple all-in-one solution
- Deciding how much you need to invest in bonds
- Understanding how money market funds work and picking a quality fund
- Weeding through other fund choices

Mutual funds fall into four main categories, each of which is discussed in this chapter. We begin with a quick breakdown:

- **Equity funds:** By far the most popular type of fund on the market, equity funds hold stocks and shares. Stocks are often called "equity" because every share is supposed to entitle its owner to an equal portion of the company. In June 2008, Canadians had $177.91 billion in Canadian equity funds, $93.43 billion in foreign equity funds, and another $21.79 billion in U.S. equity funds. These funds represent an investment in raw capitalism — ownership of businesses.
- **Balanced funds:** The next biggest category is balanced funds. They generally hold a mixture of just about everything — from Canadian and foreign stocks to bonds from all around the world, as well as very short-term bonds that are almost as safe as cash. In June 2008, Canadians had socked away $252.46 billion in domestic and foreign balanced mutual funds.
- **Bond funds:** These beauties essentially lend money to governments and big companies, collecting regular interest each year and (nearly always) getting the cash back in the end. Canadians had placed $58.68 billion in bond funds in June 2008. Bond funds have been a bit volatile lately due to the liquidity crisis that began to unravel in 2007 — a crisis that has not yet seen a sunset. Yet, they remain less volatile than balanced or equity funds.

- **Money market funds:** They hold the least volatile and most stable of all investments — very short-term bonds that are issued by governments and large companies and usually provide the lowest returns. These funds are basically savings vehicles for money you can't afford to take any risks with. They can also act as the safe little cushion of cash found in nearly all well-run portfolios. The June 2008 figure for these funds was $70.07 billion.

Equity Funds: The Road to Riches

Equity mutual funds, which buy stocks and shares of companies, are perhaps the best route to riches you'll ever find. Okay, marrying a 95-year-old, hang-gliding, suicidal millionaire in poor health may be quicker. But then you have all those whining rival heirs to fend off. Equity funds are a wonderful invention because they hold shares in a huge variety of (usually) great companies. So wide is the selection of holdings in most equity funds that if some of the businesses fail or stagnate, enough winners nearly always remain in the fund to pull you through.

Equity funds should be the core of just about anybody's investment portfolio, assuming he or she is investing for at least five years. Because the economy and well-run companies are almost certain to grow over time, stocks and shares can be the engine of growth for your money. If you want to earn decent returns on your cash over the long term, and you've decided to buy mutual funds, you're pretty well forced to buy equity funds. That's because they're the only type of fund likely to produce big returns in the long haul, possibly 10 percent or more annually. And those are the types of returns you need to defy inflation and build a substantial nest egg.

Yes, the stock market and the funds that invest in it can drop sharply, sometimes for years. So make sure you have a good chunk of bond funds in your holdings as well. But strong evidence exists that equity markets pretty well always rise over periods of ten years or more, so equity funds are a relatively safe bet for buyers who are sure they can hold on for a long time without needing all the money back at short notice.

Why investing in stocks is simple

Believe it or not, making money in the stock market is easy — in theory. You just buy *shares* — a tiny slice of ownership — in well-managed companies and then hold on to them for years. As the businesses you've invested in thrive, so do their owners, and that includes you as a shareholder. But when you actually try to select wonderful companies, things get complicated. For one thing, it's hard to tell which companies have genuinely bright prospects,

because the managers of just about every corporation do a great job of blowing their little brass horns and making everything look wonderful in their garden. And, like everything else, the stock market is subject to the whims of fashion. When investors decide they love a particular company or industry, the shares usually go to fantastic heights. At that point, buying stocks turns into a risky game — no point buying a great business if you pay four times what it's really worth.

Being fallible human beings, we constantly sabotage ourselves in the market. When everything is going well and shares are climbing to record highs, we feel all warm, fuzzy, and enthusiastic — and we stumble into the market just in time for the crash. And when the economy or the stock market is slumping, we get all depressed and sell our shares at bargain-basement prices — just when we should be grabbing more. But perhaps the biggest problem with investors is our innate belief that we're smarter than everybody else. Everybody else thinks the same thing, which means lots of us are going to end up losers. You can try to make pots of money buying speculative technology companies or penny mining stocks or companies consolidating the pallet industry, but that's really gambling. True investing in stock markets is simply buying well-established, well-run businesses and holding the shares, ideally for years.

Mutual funds are one of the very best and easiest ways to make money from the stock market. That's because mutual funds

- Are run by professionals who are trained in the art of checking out businesses
- Are set up to make it easy to put your money in and get it back
- Hold a wide variety of companies, spreading your risk and giving you the chance to benefit from growth in a huge range of industries

By handing your money over to a mutual fund company, you're saving yourself from yourself — if you aren't making the decisions, then you can't risk your savings on wild bets or crazy dreams.

The real kicker in stock market investing is figuring out whether a company is genuinely good — a quality outfit worth putting money into — and whether the price you're being asked to pay for shares is too high. Unfortunately, though, there may be no such thing as a true value for a company, because the numbers all vary so wildly according to the assumptions you make about the future. In that case, a stock is simply worth what people decide to pay for it on any given day. And that may not be very much: Stocks can dive for no apparent reason. It has happened to most of us, painfully, in our own personal investing. But there's one thing about the crazy volatile stock market we should care about, because it makes stocks and shares wonderful for ordinary people like us saving for the future. A gift, in fact, from the gods. Good companies thrive, their profits go up, and their stocks gain value over the long term.

Sometimes selecting a good company to invest in can be almost embarrassingly simple. If you shopped for a cordless phone in the early 1990s, you may have noticed that only two companies offered phones that could be described as beautifully designed, Canada's Nortel Networks Corp. and Japan's Sony Corp. High-quality design, like reliable service or clever marketing, is no accident — it requires talented people, and they don't stay long with badly run companies. Sure enough, an investor who bought either Nortel or Sony shares in early 1995 multiplied her money more than sixfold over the next five years.

Based on experience in the past century, you almost always win in the stock market over periods of at least ten years provided you stick to big, high-quality companies and you spread your risk by owning at least a dozen of them in different industries. Most equity mutual funds play it even safer by holding at least 50 different stocks (many hold 100 or more) so they can be sure of buying and selling their holdings easily.

Remember, too: It's hard to lose money in the stock market as long as you buy well-run, large companies and hold them for long enough. Studies that looked at every ten-year period in the market during the 20th century found stocks produced a profit in 99 percent of the periods, although that falls to 86 percent if you take inflation into account. Still, odds of six-to-one in your favour aren't bad.

Look at nearly any professionally run equity portfolio, such as a mutual fund, and you'll notice it contains dozens and dozens of stocks. Why so many? Why doesn't the manager just buy his or her favourite half-dozen shares and run with that? One reason is that when the market turns sour on a company its stock tends to drop like a rock. So exposing a huge proportion of your fund to a single company is a bad idea. Getting stuck with a stock nobody else wants is a fund manager's most ghastly nightmare. Whenever he or she offers the shares for sale, rival investment managers make sympathetic faces and gentle cooing noises — and then refuse to buy the garbage at anything but sub-bargain prices. Under provincial securities law, in order to protect investors, a mutual fund can have a maximum of one-tenth of its assets in a single stock. And most funds limit their exposure to individual companies to 5 percent or less.

The ABCs of picking a fund

How do you pick those high-quality conventional funds, the ones that try to buy and sell stocks? Here are three basic rules, the ABCs of selecting a great equity fund:

- First, look for a fund that's full of companies from **A**ll industries — and, in the case of global funds, **A**ll major regions of the world.
- Second, insist that your fund holds lots of big, stable, and conservative companies — the type investors call **B**lue-chip (because the blue chip is traditionally the most valuable in poker).
- Finally, look for a fund that has a habit of producing **C**onsistent returns over the years that aren't out of line with the market or with its rival funds.

The following sections take a closer look at these ABCs for picking core equity funds for your savings: Think **A**ll industries, **B**lue-chip holdings, **C**onsistent performance.

Select from all industries

A fund should hold companies from all, or nearly all, major industries, in order to spread risk — and to give unitholders a chance to profit if the stock market suddenly falls in love with a particular type of company. Here is one way to break down the industry groups:

- Banks and other financial companies, such as Citigroup, Royal Bank of Canada, or Deutsche Bank.
- Natural resource processors, such as Imperial Oil Ltd., Goldcorp Inc., or Canfor Corporation (a forest products company).
- Technology companies, such as Microsoft Corp., Intel Corp., or southern Ontario's Research In Motion; cable-TV companies like southern Alberta's Shaw Communications Inc. also fit in this group because they're battling the phone companies for control of the Internet access market.
- Manufacturers of industrial and consumer products, such as drug maker Pfizer Inc. or General Electric Corp.
- Dull but steady utility and pipeline companies such as Alberta power generator TransAlta Corp. or pipeline system TransCanada PipeLines Ltd.; telephone companies such as AT&T Inc. and Telus Corp. also officially fit into this group, although in 1999 and 2000 they frantically tried to become Internet and entertainment companies only to get caught in a financial vice as prices plunged for telephone calls.
- Retail and consumer service companies such as Canadian Tire Corp. and Wal-Mart Corp.

Not every group has to be represented in the top holdings of every fund, but a portfolio without at least one resource stock, financial services giant, or technology player among its biggest ten investments may represent a dangerous gamble. Why? Because of the ever-present chance that share prices in that missing sector will suddenly and unpredictably take off, leaving your fund in the dust. Avoid funds making bets like that.

Hold blue-chip winners

Glossy mutual fund brochures often promise the sun, moon, and stars . . . but just look at the fund's top holdings. Whether the fund is Canadian, U.S., or international, at least two-thirds of its ten biggest investments should be big blue-chip companies you or someone you trust have at least heard of. A list of the top stocks in any fund is readily available on the Internet. Look in the fund's marketing material or in the reports and documents given to unitholders. What you're looking for are big and stable firms, the type that offer the best prospect of increasing their shareholders' wealth over the years.

Talk is cheap and fund managers love to drone on about how conservative they are. But managers of supposedly careful funds can sometimes quietly take risks: They put big portions of the fund into weird stuff like resource stocks or Latin America to jazz up their returns and attract more investors. The list of top holdings is one of the most valuable pieces of information an investor has about a fund because it can't be faked or fudged (ruling out pure fraudulent reporting). If you don't see at least a few giant names in the fund's list of its biggest holdings — companies like Telus Corp., Coca-Cola Corp., Bank of Montreal, New York Times Co., General Motors Corp., GlaxoSmithKline PLC, or Toyota Motor Corp. — then the fund manager may be taking undue risks, fooling around with small or obscure companies (unless that happens to be his or her mandate as a specialty fund).

Check out past performance, with caution

After you've satisfied the first two of these conditions, look at the fund's past performance. Begin by filtering out funds that have been around for fewer than five years, unless it's quite clear someone with a record you can check has been running the money. Then look for consistent returns that aren't too much above or below the market. We all want to make lots of money, so leaving past returns until last may seem crazy, and exactly opposite to one's natural inclination. But it's the way sophisticated professionals do it. If the people in charge of a multi-billion-dollar pension fund are interviewing new money-management firms, for example, they'll ask first about the expenses and fees the money managers charge and also about the style and method the firms use to select stocks and bonds. Only then do the pros examine the past record of the managers — it's just assumed they'll be near the average.

Measuring past performance is almost as impossible as determining the true value of a company's stock — it depends entirely on complex and varying assumptions and conditions. Here's an example: Money manager Frank Mersch of Altamira Investment Services thrashed his competition for most of the early 1990s, playing resource stocks masterfully. He was a journalist's delight, always returning phone calls and providing pithy quotes. Everybody loved him, especially people with money in his fund. It soared more than

30 percent each year from 1990 through 1992, far ahead of the average Canadian stock fund. Who could blame you for deciding Mersch was good — and for putting money into his fund? But then resource stocks slid when commodity prices fell, and Mersch missed out completely on the climb in financial stocks, which rose more than 50 percent in 1997 and again in 1998. The market and his once-beetle-like rivals left him behind, and by 1999 he had departed as manager of the fund. What happened? Did Mersch suddenly become dumb or did the market turn against him through no fault of his own — or was it simply that his luck changed? Such questions probably can't be answered accurately, so let's not bother debating them. But again: Betting too heavily on yesterday's hot performers, hoping they'll outrun the pack again tomorrow, is a good way to end up in a dud fund.

Don't get too hung up about hot results in the past. Mutual fund companies like to offer lots of funds so they can have a few big performers to bray about in the ads, but those returns might be partly a result of luck. And mutual funds, incidentally, are managed more recklessly than pension funds. The temptation always exists to jack up the risk and returns a little to get the money pouring in. With a pension fund, a manager is expected to stick to a certain set of goals and investing style, and the penalties are severe for taking unauthorized flyers. That's because you have a bunch of actuaries, pension experts with thin lips and no sense of humour, keeping a watery eye on a pension fund's portfolio. But retail investors usually don't have the knowledge or resources to check or worry whether a manager is sticking to the fund's prescribed style — say, lots of fast-growing companies with high-flying stocks.

Find out what a fund's performance has been and, above all, compare it with that of rival funds and the market as a whole. The simplest place to start is the *Globe*'s quarterly fund report (available monthly online at `www.globefund.com`). Remember to stick to funds that have been around for at least five years. Also use *The Globe and Mail*'s fund Web site (`www.globefund.com`) to check whether the fund has been near the top or bottom in each individual calendar year, to detect big swings in performance over time.

Newspaper reports supply the annual compound returns for every fund as well as for the average fund in its category and for the market as a whole. If you're interested in a fund, its compound returns should be above the average for its group, but if they're way above — for example, an annual return of 15 percent over five years while the average fund made less than 10 percent — then the manager is probably a risk taker. Above all, though, be wary of funds whose returns over five and ten years are below those of the average fund: Such pooches have a dispiriting habit of continuing to bark and dig holes in the garden.

Balanced Funds

Ever have a really good roti — a West Indian treat packed with extra spices, tasty meat, and East Indian–style stuff like chickpeas? Remember the wonderful numb feeling of fullness afterward? Balanced funds are supposed to be a satisfying all-in-one meal like that. You hand your money over to the fund company or bank, and they make all the decisions. A balanced fund is a nice broad mixture of many types of investment — the idea being it'll never lose too much money. The manager usually invests the fund in a cautious blend of stocks, which are tiny pieces of ownership of companies, and long-term and short-term bonds, which are debts owed by governments and companies. Balanced funds are investment products you buy when you want nice steady returns of around 6 to 8 percent per year while avoiding losses as much as possible. They're one of the mutual fund industry's most useful inventions and an excellent place for the nervous beginner to get going. This section introduces you to the main types of balanced funds, explains why they're a great way to start off in investing, and warns you about the problems you may run into.

Understanding balanced funds

Balanced funds are for busy people who want a one-decision product they can buy and forget about. Imagine your family had a trusted lawyer or accountant who took care of all your investing needs — the professional, if he or she were at all prudent, would end up putting the money into a judicious blend of bonds and stocks, with a healthy cushion of cash to further reduce risk. And that's the essence of a balanced fund — it includes a little bit of everything so losses can be kept to a minimum if one type of investment falls in value. Balanced funds, which have been around in one form or another since the dawn of the fund industry in the 1920s, have attracted billions of dollars in recent years as confused investors decide to let someone else pick the right mix for their savings.

Reviewing the asset mix of balanced funds

Want to have some fun? Call up a balanced fund manager and during the conversation suddenly shriek, "Watch out! The market's crashing." You're bound to get an entertaining reaction. That's because the people running balanced funds tend to be nervous types who loathe losing money — great for you if you're a worried investor who can't afford to take big hits. So put your money in a balanced fund if you want someone watching over it who also hates to see things drop in value. In 2008, most balanced funds in Canada had just over 50 percent of their assets in risky-but-lucrative stocks, but the majority had about 35 percent in safer bonds. The rest was sitting on the sidelines in cash or Treasury bills.

Remember the old rule that your portfolio's weighting in bonds plus cash should equal your age? If we assume the average Canadian balanced fund has 55 percent in stocks and 45 percent in guaranteed investments like bonds and cash, then most balanced funds are suitable for investors aged about 45. So if you're younger, look for a slightly more aggressive mix, and if you're older, try to find something with more bonds.

A balanced fund should be a ready-made cautious investment portfolio. Yes, it may lose money — not much is absolutely safe in investing — but it's unlikely to drop as much as 10 percent in a year. Just check the fund's mix of assets at the fund company's Web site or in its handouts. If you see plenty of bonds and cash, it's probably safe enough to buy.

Profitable plodders

The good news is that Canadian balanced funds have done a pretty good job of avoiding losses. The average fund in the group lost less than 2 percent annually in the three, grim, bear market years that ended May 2003, while the average Canadian stock fund fell about 4 percent per year. Over ten years, Canadian balanced funds produced a respectable annual average return of about 9 percent compared with about 11 percent for equity funds. Now, of course, a few weaklings got lost in that shuffle after they were merged into better funds, but that's not a bad showing. The fund industry, always remember, has a habit of quietly folding underperformers into its stars, cancelling the dogs' years of terrible returns.

Don't worry: Balanced funds are all about simplicity. Until you make up your mind about your long-term investing plans, you'll almost certainly do fine over three to five years by simply buying a regular balanced fund, or two for more safety, and then forgetting about them.

Retiring with balanced funds

If you really want to adopt a simple approach, it's a great idea to use balanced funds in your registered retirement savings plan (RRSP) — a special account in which investment gains add up without being taxed until you take them out, usually at retirement. Balanced funds are a nice cautious mix, just the thing you want for your life savings. Younger investors can be more aggressive, putting nearly all their money into stocks, but above the age of 35 it's a wise idea to own bonds as well. Nothing is forever. If you decide later that you want something else in your RRSP, maybe because the balanced fund you picked turned out to be a dog, then it should be a simple matter to shift the money to another fund or funds within the same RRSP or to another RRSP account without incurring taxes. (See Book VI for more about RRSPs.)

So if you just want a simple investment to buy and forget, go for one or two balanced funds. Like all big mutual funds, a balanced fund has a single unit value that's published daily in the newspapers and on the Internet, making the value of your holdings easy to check. Its return appears in the papers every month and on the Internet every day. And the performance is also published clearly by the fund company. As with any regular mutual fund, if you've bought a pooch the whole world can see, there'll be some pressure on the fund manager to improve it, especially if it's managed by an independent company and not by a big bank.

Steering clear of potholes: Consistently strong returns

Balanced fund managers' scaredy-cat caution has served investors well. As stocks slid in the first half of 2003 (until about May), the average balanced fund escaped with a modest loss of about 3 percent. The worst loss the group suffered in a recent full calendar year was way back in 1994 when the average fund in the group slipped 2.4 percent. Even that loss wasn't really the fault of the managers. Interest rates jumped suddenly that year, slashing the value of the bonds they held. Otherwise, balanced funds have generated nice steady returns, just as they're supposed to. But remember that balanced funds and all other investors who own bonds have had a gale at their backs since the early 1990s, because the drop in inflation has made bonds steadily more valuable. (See Chapter 6 for more about bonds.) With inflation low — at about 2 percent in Canada in 2008 as measured by the Consumer Price Index — bonds will have a tougher time going up at the same pace. And that low-inflation environment means balanced funds could have difficulty keeping up with their flashier equity rivals.

If we move into an era of deflation (that is, falling prices), bonds will almost certainly become increasingly more valuable because the value of their steady payouts of cash rises consistently. In that case, which unfortunately could involve a very painful recession, balanced funds could easily outperform stock funds. But whatever happens, the point remains: A balanced fund is like "home safe" in a kids' game of tag in southern Ontario (the centre of the universe, as you know). It's a safe spot for your money, leaving you to get on with your life. (Okay, okay, what do you call it in Newfoundland? Squishy-jig or something, no doubt.) However, if we fall into a period of inflation, bonds will become less valuable.

Reviewing the problems with balanced funds

Problems exist with balanced funds, both Canadian and global. Their fees and expenses are far too lavish, which scythes into investors' already modest returns. Fund companies have come up with their usual bewildering variety

of products and combinations of products, waving magic wands and muttering incantations that evoke the gods of portfolio theory and the "efficient frontier." It may all be true, but one thing's for sure, Stuart: you're paying for it. All balanced products are basically porridge. Because returns from their different investments are mixed together in a gooey mess, it's hard to judge exactly how well the manager did on which asset.

High fees and expenses

The costs and fees charged to balanced fund unitholders are just too high. Fund companies already run big equity and bond funds, paying the salaries and expenses of the people who manage them, and they usually get those people to help select the stuff in their balanced funds. How much extra work is involved in that? The bond manager basically just does the same job again with his or her portion of the balanced fund, and the equity manager does the same. Some fat geezer in a huge black robe and cone-shaped hat decides what the asset mix will be and you're away to the races. But the average Canadian balanced fund vacuums up 2.5 percent of its investors' money each year, almost as bad as the 2.6 percent charged by the average Canadian equity fund.

Remember that the long-term annual return from balanced funds may be only about 6 percent, or even less. The long term, incidentally, means the rest of our lives, as economists like to say (it's the only joke they know). So, say inflation and taxes combined take 4 percent out of your annual 6 percent — then your real return is down to around 2 percent. So, for a tax-paying account, most of your real return from a balanced fund like Royal Bank's giant may go into fund expenses and fees.

Bewildering brews of assets

Fund companies know many of their customers just want simple solutions they can buy and never look at again. So they've come up with a bewildering array of balanced combinations in which you can buy their wares. Many of these arrangements, such as Mackenzie Financial Corp.'s popular "Star" products, have their own unit values, making them look very much like mutual funds themselves. By 2008, more than 1,400 Canadian and global balanced products of all types existed, counting different "classes" of fund units as separate funds. It's enough to make you wonder how many Star investors, or even their brokers, would have had problems identifying exactly which one they owned.

Difficulty judging fund manager performance

A big difficulty with balanced funds, or any kind of casserole you buy from a fund company, is that it's usually hard to know just what the manager did right or wrong. He or she may have blown it in bonds, or struck out in stocks,

but it's impossible to work out from the comfortable-looking (you hope) overall return number the company publishes. Some fund companies provide a commentary that at least gives you a clue as to what went right and what exploded in the manager's shiny little face. For many customers that's fine, because they couldn't care less what went on inside the fund as long as the return is reasonably good. And that's a perfectly sensible approach to take if you don't have the time or interest to look further into mutual funds. But balanced funds are opaque and mysterious, violating one of the huge virtues of mutual funds — the ability to check on performance easily.

Because it's difficult to check where balanced funds' profits came from, it's harder for you to pick the right fund. In other words, often no clear answer exists to the crucial question: How much risk did the manager take? Here's an extreme example of two imaginary funds to help illustrate the point.

Suppose you're trying to choose between two balanced funds:

- First, the Tasmanian Devil Fund, which made an average 11 percent over the past ten years, enough to turn $10,000 into $28,394.
- And then, the Mellow Llama Fund, which made 9 percent a year. That turned $10,000 into $23,674, or almost $5,000 less.

What if the Devil Fund made its bigger profits by buying bonds and shares issued by risky little technology companies, whereas the Llama Fund owned shares and bonds from big and stable companies and governments? Most balanced fund investors would choose the second fund, because the danger of it crashing and losing, say, half of its value in a year is so much less.

The Devil Fund, with its volatile but high-profit-potential stocks, may be suitable for an investor who doesn't need the money for years and can afford to take risks now. But it's not the right fund for an investor who may need the money at any time.

Bond Funds: Boring Can Be Sexy Too

Buying a bond means you're lending money to the government or company that issued the thing. The word "bond" means promise, indicating the borrowers have given their word they'll be around to pay interest and refund the loan. All you're really entitled to get are the periodic interest payments plus the return of all your money when the debt comes due. Dull, huh? Bond funds simply hold a bunch of these loans, collecting the interest cheques and cashing in the bonds when they mature unless the bonds have been sold before maturity — we hope for a nice profit. That means bond funds tend to plod

along with modest returns, while stocks fly and crash from year to year. Equity (or stock market) funds, with their promise of apparently limitless growth, just seem so much more exciting. But remember that bonds along with stocks represent the two main financial assets you can invest in for the long term — while a little bit of cash on the side is an essential safety valve for nearly any portfolio. This section explains why we suggest you own at least one bond fund, and shows you how to pick a good one.

Discovering some great reasons to choose bonds

Here's why you must own some bonds or bond funds: Lending your money short-term, by popping it into a bank deposit or account, doesn't pay you enough. Okay, so you can invest most of your money in the stock market, but that's a recipe for losing some of your pile if the market goes into a huge dive. So some of us should leave a portion on long-term loan to big, secure governments and companies. And the way to do that is to buy their bonds, which are essentially certificates representing interest-paying loans to the corporations or governments that issued the bonds.

Declining interest rates, a result of falling inflation, have put a tiger in the tank of bond funds for more than a decade. The average Canadian bond fund produced an annual compound return of 8.5 percent in the 1990s, not far short of the 9.6 percent return from Canadian equity funds. And stocks, remember, are supposed to perform much better than bonds to compensate for their extra risk. As of mid-2008, the ten-year average annual return from bond funds had slipped to about 6 percent — but that was mostly because the record no longer included 1991, when the average bond fund shot up almost 20 percent as inflation dropped sharply (bond buyers hate inflation because it erodes the value of the money they'll get back years hence when their bonds mature). That 6 percent didn't look too shabby when compared with the 9 percent average return from ever-risky Canadian equity funds. And in the scary three years that ended in mid-2003, bonds came shining through: The average bond fund made 5.7 percent annually in the period, while the average Canadian stock fund lost about 5 percent per year.

But bonds will have trouble doing as well in coming years. Inflation was hovering at about 4 percent in mid-2003, meaning it didn't have much more room to drop (unless we slide into scary deflation). That limited the scope for falling interest rates and higher bond prices. And if inflation and rates rise, then bond prices will drop, dragging down bond funds.

Get some sleep with bonds

Psychologically, having your entire savings in stocks is just too frightening for most normal people. The Standard & Poor's/Toronto Stock Exchange composite index dropped by one-fifth, or 20 percent, during one month (August 1998) as the economies of Russia and Asia threatened to go down the plughole. From August 2000 to August 2001, the heart of the bear market, the index fell by more than 33 percent. Watching your life savings shrink at that speed would be no fun at all. Don't believe it? You will when you're sitting bolt upright at 4 a.m. reflecting on the minus signs next to those equity funds you thought couldn't miss "over the long term."

What goes up must come down, even the market

Sure, equities have always bounced back in the past. But stocks can go into a slump for years, just as they did in the inflation-and-recession-prone 1970s. From February 1966 to August 1982, a stretch of 16 long years, the Dow Jones Industrial Average of blue-chip U.S. stocks fell 22 percent in price.

Yes, America's blue-chip companies paid regular dividends during the period, reducing investors' losses. But it was still a horrible time to be in the market, a depressing and endless era of new lows.

Remember Japan and the way its market hit a euphoric peak in 1989 (just as technology and communication stocks all over the world did in 2000)? More than a decade later, the Japanese market was still down from its 1989 high.

Have some security if you hit a rough patch

You may lose your job, have legal troubles, or run into some disaster right in the middle of a periodic stock market slump. It would be ugly to be forced to tap into your serious money just after it's been carved up by a stock sell-off. So own some bonds. They serve as a giant, reassuring outrigger for your canoe, producing steady returns while holding their value.

Beware of falling prices

Finally, and perhaps most scary of all, companies and individuals all over the world are getting smarter and more efficient all the time. Why is that a problem? It means they're producing goods and services at ever-lower prices. Inflation in most wealthy countries has dropped to less than 3 percent from double figures in the 1980s, and it could keep right on falling until we're in an era of actual falling prices. If that happens, bonds and cash are likely to hold their value or even rise in price because the value of money will be rising (inflation, the opposite scenario, simply means money is losing its purchasing power). In other words, deflation is a weird *Through the Looking Glass* world in which cash under the mattress becomes a solid investment that produces a real return.

Picking a good bond fund in 30 seconds

Selecting a superior bond fund boils down to two simple rules. It should hold plenty of high-quality, long-term bonds, and it must have low expenses. You can find funds with low expenses, and check their holdings, at `www.globefund.com` — *The Globe and Mail*'s mutual fund Web site.

Here's more good news: We suggest you own at least two Canadian and two global stock funds, because any equity manager can go into a slump for years. But you'll almost certainly do fine with just one bond fund, as long as it has low annual costs and is full of quality bonds. No big fund seller would allow its managers to make weird bets with a mainstream bond fund, such as buying 20-year paper issued by a bankrupt tin mine. The backlash from investors, the media, and possibly even regulators would be too great.

Insist on affordability

Demand modest annual expenses — less than 1 percent annually — with any bond fund. The returns from this asset class are relatively low, and likely to get lower in coming years because bonds are already trading at fat prices. So fund costs and fees must be kept down for the investor to be left with anything at all after taxes and inflation.

The average Canadian bond fund hits its unitholders for a criminal 1.8 percent annually, and plenty of funds in the group grab 2 percent or more. That's ridiculous and here's why. In mid-2008, ten-year Canadian government bonds were offering a tiny annual yield of about 4.5 percent to investors who bought them and held them to maturity. Now, bond managers can sometimes increase returns by a few tenths of 1 percent by fancy trading, but unless interest rates drop rapidly over the next few years, it looks very much as though 5 percent or so is all many bond portfolios are likely to make annually. Take out a 2 percent expense ratio, and you're left with only 3 percent. After inflation and taxes, in other words, bond fund unitholders could easily end up losing money in real terms.

So, in general, look only at bond funds with annual expenses of 1 percent or less. The funds with low expenses will almost all turn out to be no-load products you buy directly from a bank or direct-selling fund company. That's because fund companies that sell through brokers, financial planners, and other advisers have to add on extra charges in order to have something left over to pay the salespeople; expect to pay an extra 0.75 percent annually on most broker-sold bond funds. Better still, buy your own bonds. Ask an investment adviser about building your own bond portfolio so you can eliminate annual bond fund fees.

Look for quality in provincial and federal bonds

If you must, then buy a fund with plenty of high-quality long-term federal government and provincial bonds. A few super-blue-chip company bonds are okay, but remember that with business changing at the speed of Bill Gates's rubbery mind, today's corporate grande-dame could be tomorrow's bag lady. So go easy on the IBMs. If you're a bit nervous that inflation might come back, you want a middle-of-the road solution when it comes to bonds. So just get a bond fund that pretty well matches the SCM Universe Bond Total Return Index, an imaginary basket of typical high-quality bonds calculated by huge investment dealer Scotia Capital Markets. The SCM Universe pretty well represents the entire Canadian bond market.

Why should you look for long-term bonds? If you have a home mortgage, you probably know the best thing to do as a borrower in recent years has been to keep renewing your mortgage for short terms at low rates instead of "locking in" for a longer term at a higher rate. But for lenders, such as buyers of a bond fund, the opposite strategy has been better. Lending long, by buying long-term bonds with ten or more years to run before they mature, has been the most lucrative approach because short-term interest rates kept dropping. Now the next ten years may be different, but we still suggest that you just buy a plain bond fund that's got plenty of long-term Canadian government bonds.

For the serious money portion of your portfolio, avoid risky "high-yield" bond funds or sleepwalking "short-term" bonds. Apply this rule: Bet long-term as a lender because that's where the yield is. Consider this old saying in the bond market: *Be long or be wrong.* If you want a compromise, buy a plain-vanilla bond fund whose average term to maturity is close to the SCM Universe Bond Total Return Index, which includes both short- and long-term bonds. Many fund companies and bond investors use the SCM Index as the benchmark with which they compare the performance and holdings of their funds.

Money Market Funds: Welcome to Sleepy Hollow

Money market funds are simply a safe parking spot for cash, designed to produce at least some sort of return. They generate a modest stream of income — annual returns from the group averaged about 4 percent in the ten years that ended in mid-2008. These funds invest in very short-term bonds and other fixed-income securities such as government Treasury bills and corporate commercial paper that usually have less than 12 months to go before they mature and the issuer pays back the holders' money. Money market funds are different in structure from normal mutual funds, and the way they calculate their

returns can be confusing. But just use the same rules to pick one that you use with bond funds: Buy quality and, more than ever, insist on low expenses — 1 percent annually at the very most. As with all mutual fund investing programs, when buying a money market fund do more than just insist on low costs. Lean across the table — glaring at the hapless salesperson through bulging, insane eyes — part your spit-flecked, crusty lips, and scream for a reduction in expenses at the top of your voice. Otherwise, you won't make anything off a money market fund. This section shows you why money market funds are a great place to hold your cash while you wait to spend or invest it. It also shows you how to spot a good money market fund.

Understanding how money market funds work

Throughout this chapter and the preceding one, you've read a tonne of grim warnings about how you can easily lose money in mutual funds because of a drop in their unit price. Well, risking contradiction, that doesn't apply to the vast majority of money market funds because they are held steady at a fixed value, usually $10 per unit.

Some money market funds — especially the guaranteed type that promise to refund some or all of your money — have unit prices that do increase over time.

Keeping the unit price fixed isn't required by law, but it's the practice among fund companies. In theory, if short-term rates were to shoot up exponentially or the government's credit rating collapsed in some kind of unprecedented catastrophe, the fund company would let the value of your money market units drop. But by that time, you'll be too busy pitching bottles at the giant green spacecraft that just zapped your dog to worry much about it. In other words, woe betide the fund company that lets its money market fund units drop below their fixed value. Investors who buy this type of fund aren't known for their devil-may-care attitude to losses. It's more a kind of grim-glare-where's-my-money type of situation. So money market funds are rather like a guaranteed investment certificate: You're certain to get your cash back, plus extra units representing the interest you've earned along the way.

The interest is usually calculated daily, but it's generally added to your account every month or when you sell your units. Money market funds, like nearly all mutual funds, however, beat the pants off guaranteed investment certificates (GICs) because they're "liquid." That's a bit of investment industry jargon that simply means you can turn the investment into ready cash at a moment's notice. Unlike GICs, money market funds refund your money without penalty, usually at a day's notice.

As a guideline, the return from money market funds tends to be almost exactly the same as the return from one-year GICs. GICs earned an annual average of 5 percent in the ten years that ended mid-2008, essentially the same as the return from Canadian money market funds.

In other words, both fixed one-year deposits at the bank and money market funds gave you an annual yield of about 5 percent over a decade. That's only about half the 9 percent yearly return investors got from the average Canadian balanced fund, though — normally a pretty cautious mix of stuff from the stock market (which is always volatile) and bonds (which usually work in great slow cycles).

The *yield* is just the harvest you get on your money, expressed as a percentage of what you invested. So, a madcap biotech fund might go up 50 percent in a year — at huge risk — turning $1,000 into $1,500 (always assuming you were canny enough to sell out in time before it crashed). A money market fund in late 2000 offered an annual yield more like 4.5 percent, which would transform $1,000 into just $1,045 but at very little risk. But by mid-2003, as inflation stayed low, that yield had slumped below 2 percent, making money market funds much less attractive for investors. We're talking about a return of 20 bucks for tying up $1,000 for a year.

So remember that with a money market fund, you nearly always buy a set of units at a fixed price, usually $10 in Canada and $1 in the United States, and that unit price never changes. Your return comes in the form of extra units paid out to you along the way. You're not going to get wealthy soon with one of these funds. Just like bond funds, they're designed only to earn a steady and fairly predictable return. None of the flash, risk, and potential for big gains you get with an equity fund exist.

Selecting winning money market funds

Don't stay up all night picking a money market fund, because you've got a busy day ahead. A long day of sliding through sticky mud, trying to get a grip on infuriated ostriches. Money market funds tend to be pretty similar. In other words, no point exists in chasing a big yield, because to get one the manager has to take more risk. If you're buying your other mutual funds at a bank or bank-owned discount broker, simply buy the bank's money market fund. Competition in the industry makes it embarrassing for a bank to have its money market fund turn into a hound. If you're buying through an investment adviser or other commissioned salesperson, his or her office is probably set up to put clients into a particular money market fund, probably from the fund company the salesperson's organization does the most business with. Because money market funds are just temporary holding spots for cash — or they constitute the low-risk, low-return "cash" portion of your portfolio — then one fund is pretty well as good as another.

Just make sure you can find the money market fund listed in your daily newspaper, in a newspaper monthly report, or on the Internet. That way, you know you'll be able to track your holdings and check the accuracy of your account statement.

Choosing from a mix of money market funds

Some money markets are ultrasafe, sticking to government bonds. Others increase the risk level very slightly, and pick up about one-fifth of a percentage point in annual yield. Either choice is fine — it depends on your personality. Here's how to tell the two options apart:

- For their very nervous clients, the banks offer a superconservative "T-bill" fund that buys only short-term government bonds and government Treasury bills (a type of bond with up to 12 months before it matures).
- For those willing to take a bit more risk, the banks offer slightly lower-quality funds — usually known simply as money market funds — that are allowed to increase their yield by buying things like corporate "commercial paper"; that is, short-term debt issued by big companies when they need a bit of cash to tide them over. These funds really aren't dangerous at all, because the companies that issue the paper they hold are nearly always blue-chip multinationals or their Canadian subsidiaries.

It would take a very nasty economic cataclysm indeed before any bank-run money market racked up losses big enough to force the bank to let the fund's unit price drop. So no significant difference exists between the two types of funds.

World travellers: U.S. money market funds

A handful of companies also offer foreign money market funds, either for investors who want to hold a lot of cash in U.S. dollars or for scaredy-cats who want a low-volatility investment safe from a drop in the Canadian dollar. Nearly all the funds in this group are bought and sold in U.S. dollars. The same rules apply to pick a fund. Look for low expenses if you want to end up with anything. Don't believe me? Look what happened to unfortunate investors in the AIM Short-term Income Fund. The fund's Canadian class B units came with annual expenses of 2.7 percent — which left investors with an average annual return of only 1.8 percent in the five years that ended mid-2008, compared with about 5 percent for the average U.S. money market fund. In other words, investors paid out more to the fund company than they got back in returns.

The average foreign money market fund has expenses of 1.2 percent, so refuse to pay anything more than that.

Is thin in? Watching those pesky expenses

Always remember that because the returns from money market funds are so thin, the slightest increase in expenses can leave you with nothing after taxes and inflation. So refuse to pay a sales commission when buying a money market fund. The broker or salesperson should be able to let you have it commission-free, especially if you're simply parking your money in the money market fund temporarily while you decide on a long-term home for it. Take five minutes to fire up `www.globefund.com` or check the listings in the monthly fund guide printed with your newspaper to check that the money market fund recommended by your bank or salesperson has produced acceptable returns. It probably has. And remember that the average Canadian money market fund has expenses of 1.1 percent — you shouldn't be asked to pay more than that.

Examining Other Types of Funds

In June 2008, some 2,038 mutual funds totalling $700 billion in assets were held in almost 53 million unitholder accounts in Canada. Each fund was different from the others, especially when it came to making money for investors in the fund. Don't let this bewilder you. All mutual funds can be grouped into one of a number of broad categories, starting with the categories of funds described earlier in this chapter (equity, balanced, bond, and money market). Here are some brief descriptions of other categories of funds to help eliminate the mystery of mutual funds:

- **Special equity or sector funds** limit themselves to investing in gold, real estate, science and technology, and almost any other industry according to the fund's guidelines. These funds tend to vary widely in value because they are not as diversified as other equity funds. In fact, some advisers consider them almost speculative in nature, and question their value inside an RRSP. Generally, these should make up no more than 5 or 10 percent of an RRSP's total value, and then only if you are a) young, b) ready to accept possible losses in your investment, or preferably c) both.
- **Dividend funds** invest in common and preferred shares of companies expected to pay high, long-term dividends. Some capital growth can be expected as well, but these funds primarily represent an opportunity to generate income.
- **Global or international funds** mirror other funds described previously in this list, except that they function almost exclusively outside of Canada. This makes them ideal for some of your RRSP, but beware: International funds may limit themselves to one country or region, such as India or Japan. They may also focus exclusively on developing or emerging markets, which include Latin America and some Asian countries. Focusing on one region, or one type of country, defeats the prime purpose of investing beyond Canada, which is to build as much diversification as possible

into your RRSP. Better to choose funds that invest anywhere the fund manager finds the best prospects.

Exceptions always exist, of course. Funds investing in the U.S. performed exceptionally well during most of the 1990s, reflecting that country's strong economic growth. But all well-managed global equity funds, such as AGF International Value, Spectrum Global Growth, CI Global, and others, had already invested heavily in the U.S. market. They profited from the U.S. market's growth. Unlike funds investing exclusively in the United States, however, these global funds will be able to move elsewhere when the U.S. market is not performing as well as others.

- **Open** and **closed funds** describe the structure of the fund, not the investments they hold.

  An *open fund* is the most common fund structure. It enables you or any investor to buy or sell units in the fund at any time at the current unit price, which is based on the total net assets of the fund at the end of the day divided by the number of units in the fund. That's the price you'll receive per unit if you sell and the price you'll pay if you buy, and it's fixed by the market value of the fund's investments. Open funds have to keep a fair amount of cash or liquid assets on hand in case more people want to sell their units than buy them. (Other reasons apply as well, but this is a practical requirement.)

  A *closed fund* is really like a separate company investing in other companies or securities on the market. Managers of closed funds invest money from shareholders just as they would in an open fund. But when the fund reaches its target investment limit, no further shares are issued. Instead, the fixed number of shares are bought and sold just like shares in IBM, Royal Bank, and Goldcorp. As a result, the price of the shares does not reflect the actual asset value so much as the *perceived* value of people who may want to own them. Units in closed funds are not as liquid as open funds, so they're suitable for folks who limit their investments primarily to their RRSP. Until you build your investment knowledge, it's best to stay with open funds.

Other types of funds you may encounter include the following:

- **Pooled funds,** generally created for wealthy, sophisticated investors. If this includes you, we're flattered you're reading this book.
- **Segregated funds,** which are a combination of mutual fund and insurance policy, to prevent any loss of capital.
- **Labour venture funds** are designed for labour unions to use when investing in smaller companies just starting up. They offer attractive tax incentives and a few have finally begun producing reasonable results.
- **Royalty trusts** are a version of mutual funds that disperse income earned from their investments to the fund shareholders. Real estate investment trusts are also available.

Chapter 3

The Essentials of Stock Investing

In This Chapter

- Knowing the essentials
- Recognizing winners
- Exploring investment strategies
- Considering the best stocks for the short, medium, and long run
- Understanding why you're investing
- Investing to match your personal temperament

Stock investing became all the rage during the late 1990s, when many Canadian investors watched their stock portfolios and equity mutual funds skyrocket in value as major North American markets enjoyed the fruits of an almost two-decade-long rising market (better known as a *bull market*).

Then came the dreaded *bear market* — complete with claws, sharp teeth, and almost four years of declining markets. Portfolios were mauled, chewed up, or worse. Investors with positive, or even zero, returns had downright bragging rights! Yet despite this recent roller coaster of a ride, almost half of Canadian households are still invested in stocks today. Some of these Canadians hold stocks directly; others hold them indirectly in their mutual and pension funds. Canadians are a resilient bunch: Although many of us got scared, we did not jump ship en masse!

The ongoing high level of investment activity in Canada and the United States is a shining indicator of the popularity stocks continue to experience. Yet many people still don't know exactly what they are investing in, or the risks they face. When you have a clear understanding of what a stock really represents, you can avoid making expensive mistakes and be able to use some defensive manoeuvres when entering into high-risk investments.

The purpose of this chapter is not only to tell you about the basics of stock investing, but also to let you in on some sharp strategies and tactics that can help you profit from the stock market. Before you invest your first dollar, you need to understand the basics of stock investing.

Understanding Stock Market Basics

The stock market is, well, a market for stocks. In essence, being in the market is like trading hockey cards. The market is the schoolyard where buyers and sellers get together to trade cards. A sharp hockey-card trader (buyer) will try to guess which rookie player is the next Wayne Gretzky or Mario Lemieux. If a trader thinks Sidney Crosby is that player, he or she will buy a bunch of Crosby's rookie cards today, hoping Crosby will score lots of goals or get lots of assists in the future. If so, the card will almost certainly rise in value! The best price to pay is the lowest cash price, or the fewest cards traded away in return. The owner of the card (the seller) will either recognize greatness and ask a hefty price or fail to see Crosby's potential and trade the card away for a song. In the hockey-card trading market (the schoolyard), you have kids who are buyers and kids who are sellers. They may pay or get cash, and they may give up on some cards to collect others.

The real stock market is an established group of separate markets (many schoolyards in many countries) where investors can freely buy and sell millions of shares issued by thousands of Canadian and international companies. Like hockey cards, investors buy stocks because they seek gain in the form of *appreciation* (which happens when their stock, if held long enough, goes up in value — just as Wayne Gretzky's rookie card did), income (some stocks pay income in the form of dividends), or both. (Sorry, hockey players don't pay out dividends!) Those who already own stock may sell it to cash in and use the money for other purposes. Either way, investors pay or get cash, or give up on some stocks to try different stocks with the proceeds. A market is made!

Why companies go public and sell stock

Companies issue stock because they need money for a particular purpose. The first time a company sells stock to the public is known as an initial public offering (IPO), sometimes referred to as "going public." The most prominent new Canadian and American stock IPOs are usually reported in the pages of financial publications such as *The Globe and Mail,* the *National Post,* and *The Wall Street Journal.*

Generally, two types of companies go public by issuing stock:

- **An existing private company:** A company currently in operation as a private corporation but wants to expand.
- **A start-up company:** A company just starting up that decides to go public immediately to raise the capital necessary to establish itself.

Between the two types of companies, the safer situation for investors is the first. This kind of company has a proven track record — which hopefully includes growing sales, cash profits, and great ideas!

Why does a company go public? Because it needs to raise the money necessary for its growth and financial success. More specifically, the money raised through a public offering of stock can be used for the following purposes:

- **Raising capital and financing expansion:** If ABC Corporation wants to increase its production capacity, it needs a new manufacturing facility. In order to raise the capital needed to build and operate the new facility, it may decide to sell stock to the public.
- **Investing in product (or service) research and development:** Many companies need money for the research and development of new inventions or innovations.
- **Paying for the daily expenses of doing business:** Most companies have to pay for staff, benefits, utilities, marketing efforts, and so forth. Some companies may need additional operating capital until revenues from exciting new products and services catch up with and exceed expenses. (At least, that's the plan!)
- **Paying off debt:** The company may want to use the proceeds of a stock sale to pay off its debts. Interest expense is the number-one financial anchor that causes companies to go bankrupt.
- **Funding miscellaneous projects:** The company may need money for undertakings important to the health and growth of the enterprise, such as joint ventures and brand-new lines of business.
- **Executive recruiting:** The company wants to attract the best staff. These people want a piece of the pie so they can increase the value of their piece — and then sell that piece.

Enough said about *why* a company goes public. In terms of *how* a company goes public, when a private company wants to offer its stock to the general public, it usually asks a stock underwriter to help. An underwriter is a financial company that acts as an intermediary between stock investors and public companies. The underwriter is usually an investment banking company or the investment banking division of a major brokerage firm. The underwriter may put together a group of several investment banking companies and brokers. This group is also referred to as a syndicate. Usually the main underwriter is called the primary underwriter, and others in the group are referred to as subsidiary underwriters.

Before a company can sell stock to the public, a couple of things have to happen:

- The underwriter or syndicate agrees to pay the company a predetermined price for a minimum number of shares and then must resell those shares to buyers such as their own clients (which could be you or me), mutual funds, and other institutional investors. Each member of the syndicate agrees to resell a portion of the issued stock. The underwriters earn a fee for their underwriting services. CIBC World Markets is one example of an underwriting company. Its investment banking business works with companies to help them raise capital, grow, and invest.
- The underwriter sets a time frame to start selling the issued stock (the window of time within which the primary market is taking place). The underwriter also helps the company prepare a preliminary prospectus that details financial and business information for investors, such as the amount of money being sought in the IPO and who is seeking the money, and why. (For details, see the section "Canadian regulators and toothless tigers," next.)

Keep in mind that a stock offering doesn't always have to be issued in a first-time situation involving a private company going public. Companies that already issue publicly traded shares may issue more stock in secondary offerings to gain the extra capital needed for expansion or other purposes.

Canadian regulators and toothless tigers

The market for all public stocks is now regulated reasonably well in the United States by the Securities and Exchange Commission (SEC). Most recently, the Conrad Black case is proof the U.S. is still pursuing and acting on allegations of corporate wrongdoing. However, the SEC is currently having its rules of supervision examined due to its failure to recognize the sub-prime credit crisis enabled by the investment dealers on Wall Street. The SEC sets the standard for disclosure and governs the creation of the prospectus. The prospectus must contain information such as the description of the issuer's business, names and addresses of the key company officers, key information relating to the company's financial condition, and an explanation of how the proceeds from the stock offering will be used.

In Canada, provincial and territorial securities administrators — also known as securities commissions — oversee and govern the securities industry. Unlike the SEC, they operate at a more local (provincial) level. They possess broad powers under provincial statutes called Securities Acts. Securities

commissions don't pass judgment on the worthiness of an investment. Rather, they try to provide assurance that companies offering securities furnish investors with good and complete disclosures of all key and relevant facts. A company provides this disclosure through a prospectus, and subsequently through updates such as annual reports and other statutory declarations.

Regulators promote integrity in the stock market and help provide a more level playing field. Although the Canadian stock market regulatory system is established and efficient, it is still not as effective and innovative as its American counterpart. That's because companies can get away with corporate malfeasance more easily in Canada than they can in the United States. Incredibly, at the time of this writing, Nortel was still busy restating its financial statements from many years past! Even after the Canadian system reveals questionable acts by public companies, the system is still generally toothless — it has a bark but not much of a bite. Some token prison sentences may be handed out to executives who perpetrate fraud, but relative to the United States, very few corporate crooks in Canada wind up behind bars. A lack of adequate personnel, relevant legislation, and strong political will are all likely at fault. At any rate, the road to full regulation in Canada remains long, and tougher measures are still needed to this day.

If you're planning on becoming a stock investor, know about Canada's relatively lax regulation so you can be proactive in identifying risks and in knowing your rights.

Also know that investment firms and their representatives must be registered with their respective provincial securities commission — either where they work or where they trade securities — and that they have to meet certain standards to become registered.

Securities commissions can cancel the registrations of individuals or the firms they work for to protect your interests. They're also empowered to investigate matters, prosecute persons, freeze funds, hear facts, take evidence, impose penalties, and/or seize documents for examination. However, securities commissions can't compel a company or individual to repay investors. All they can do is halt trading in a security and deny the violator the right to trade securities in the province. Although, sadly, still no federal regulatory body exists in Canada (as in the U.S.), each provincial securities commission is a member of an umbrella organization, the Canadian Securities Administrators (CSA). CSA members work to standardize securities law. The securities industry also self-regulates through the Investment Industry Regulatory Organization of Canada (IIROC). (You can find out more about the CSA and the IIROC in Chapter 7.)

Your role and rights as a shareholder

When you own stock, you become a *shareholder* (also known as a *stockholder*). The benefit of owning stock in a corporation is that whenever the corporation profits, you should profit as well. For example, if you buy stock in ATI Technologies Inc. and ATI comes out with an exciting new computer graphics product the public wants in massive quantities, not only does the company succeed but so do you, depending on how much stock you own.

Just because you own a piece of that company, don't expect to go to the company's headquarters and say, "Hi! I'm a part owner. I'd like to pick up some office supplies because I'm running low. Thank you and keep up the good work." No, it's not quite like that. Instead, you participate in the company's overall performance at a distance. As an owner, you participate in the overall success (or failure) of a given company along with the thousands or millions of others who are *co-owners* (other investors who own stock in the company). The flip side is that if the company is sued or gets on the wrong side of the law, you won't be in trouble — at least not directly. The company's stock value will be negatively affected, and you'll most likely see a decline in the value of your stock, but you won't go to jail.

A stock also gives you the right to make decisions that may influence the company, such as determining the share price. Each stock you own has a little bit of voting power, so the more shares of stock you own, the more decision-making power you have. In order to vote, you must attend an annual or special shareholders' meeting, or fill out a proxy ballot. The ballot contains a series of proposals you may vote either for or against. Common questions concern who should be on the board of directors, whether to issue additional stock, and whether to acquire or be acquired by another company.

Knowing How to Pick Winners

Successful stock picking is not mysterious, but it does take some time, effort, and analysis. It's worth it because stocks are a convenient and important part of most investors' portfolios.

Recognizing stock value

Imagine you like bacon and you're willing to buy it at the grocery store. In this example, the bacon is like a company, and its prices represent the prices you would pay for the company's stock. The grocery store is the stock market. What if two brands of bacon are very similar, but one package costs three dollars while the other costs four dollars? Which would you choose?

Odds are you would look at both brands, judge their quality, and, if they were indeed similar, take the cheaper package. The bacon selling for four dollars is overpriced. The same is true of stocks. What if you compare two companies that are similar in every respect but have different share prices? All things being equal, the cheaper price has greater value for the investor. But the bacon example has another side.

What if the quality of the two brands of bacon is significantly different, but their prices are the same? If one brand of bacon is fatty, of poor quality, and priced at three dollars, and the other brand is lean, of superior quality, and also priced at three dollars, which would you pick? You'd take the good brand because it's better bacon. Perhaps the lesser bacon would be an acceptable purchase at 50 cents — you can feed it to your hamster — but it's definitely overpriced at three dollars and is risky to your health! The same example works with stocks. A badly run company isn't a good choice if you can buy a better company in the marketplace at the same — or a better — price.

Comparing the value of bacon may seem overly simplistic, but doing so does cut to the heart of stock investing. Bacon and bacon prices can be as varied as companies and stock prices. As an investor, you must make it your job to find the best value for your investment dollars. Okay, we're all probably getting a bit hungry now. Time to move on!

Understanding how market capitalization affects stock value

You can determine the value of a company (and thus the value of its stock) in many ways. The most basic way to measure this value is to look at a company's market value, also known as market capitalization (or market cap). Market capitalization is simply the value you get when you multiply all the outstanding shares of a stock by the price of a single share.

Calculating the market cap is easy. It's the number of shares outstanding multiplied by the current share price. If the company has 1 million shares outstanding and its share price is $10, the market cap is $10 million.

Small cap, mid cap, and large cap aren't references to headgear; they're references to how large the company is as measured by its market value. The five basic stock categories of market capitalization are:

- **Micro cap (under $250 million):** These stocks are the smallest and, hence, the riskiest available.

- **Small cap ($250 million to $1 billion):** These stocks fare better than the micro caps and still have plenty of growth potential. The key word here is "potential."
- **Mid cap ($1 billion to $5 billion):** For many investors, this category offers a good compromise between small caps and large caps. These stocks have some of the safety of large caps while retaining some of the growth potential of small caps.
- **Large cap ($5 billion to $25 billion):** This category is usually best reserved for conservative stock investors who want steady appreciation with greater safety. Stocks in this category are frequently referred to as *blue chips.*
- **Ultra cap (over $25 billion):** These stocks are also called *mega caps* and obviously refer to companies that are the biggest of the big. Stocks such as General Electric and ExxonMobil are good examples.

From a safety point of view, a company's size and market value do matter. All things being equal, large-cap stocks are considered safer than small-cap stocks. However, small-cap stocks have greater potential for growth. Compare these stocks to trees: Which tree is sturdier — a giant California redwood or a small oak tree that's just a year old? In a great storm, the redwood holds up well, while the smaller tree has a rough time. But you also have to ask yourself which tree has more opportunity for growth. The redwood may not have much growth left, but the small oak tree has plenty of growth to look forward to.

For beginning investors, comparing market cap to trees isn't so far-fetched. You want your money to branch out without becoming a sap.

Although market capitalization is important to consider, don't invest (or not invest) based just on it. It's only one measure of value. As a serious investor, look at numerous factors that can help you determine whether any given stock is a good investment. Keep reading — this book is full of information to help you decide.

Sharpening your investment skills

Investors who analyze a company can better judge the value of the stock and profit from buying and selling it. Your greatest asset in stock investing is knowledge (and a little common sense). To succeed in the world of stock investing, keep in mind these key success factors:

- **Analyzing yourself:** What do you want to accomplish with your stock investing? What are your investment goals?
- **Knowing where to get information:** The decisions you make about your money and what stocks to invest in require quality information.
- **Understanding why you want to invest in stocks:** Are you seeking appreciation (capital gains) or income (dividends)?
- **Doing some company-specific research:** Look at the company whose stock you're considering to see whether it's a profitable company worthy of your investment dollars.
- **Choosing a winning industry:** You'll frequently see that stock prices of mediocre companies in hot industries rise higher and faster than solid companies in floundering industries. Therefore, choosing the industry is very important.
- **Understanding how risk affects your stock:** Companies and their stocks succeed or fail in large part due to the internal and external environment in which they operate. Operating and governance risks are what bit the Enrons and WorldComs of this world — and their shareholders. Economic and political risks can move entire stock markets into a downward spiral. Definitely know something about these risks before you invest in stocks.
- **Understanding and identifying megatrends:** Doing so makes it easier for you to make money.
- **Using stock trading strategies like the pros do:** In other words, how you go about investing can be just as important as what you invest in. We are very big on trading strategies such as trailing stops and limit orders.
- **Keeping more of the money you earn:** After all your great work in getting the right stocks and making the big bucks, you want to know about keeping more of the fruits of your investing.

Matching Stocks and Strategies with Your Goals

Before investing in a stock, ask yourself, "When do I want to reach my financial goal?" Stocks are a means to an end. Your job is to figure out what that end is — or, more important, when it is. Do you want to retire in ten years or next year? Must you pay for your kid's university education next year or 18 years from now? The length of time you have before you need the money you hope to earn from stock investing determines what stocks you buy. Table 3-1 gives you some guidelines for choosing the kind of stock best suited to the type of investor you are and the goals you have.

Table 3-1 Stock Types, Financial Goals, and Investor Types

Type of Investor	*Time Frame for Financial Goals*	*Type of Stock Most Suitable*
Conservative (worries about risk)	Long-term (over 5 years)	Large-cap stocks and mid-cap stocks
Aggressive (high tolerance to risk)	Long-term (over 5 years)	Small-cap stocks and mid-cap stocks
Conservative (worries about risk)	Intermediate-term (2 to 5 years)	Large-cap stocks, preferably with dividends
Aggressive (high tolerance to risk)	Intermediate-term (2 to 5 years)	Small-cap stocks and mid-cap stocks
Occasional	Short-term (2 years or less)	Stocks are typically not suitable for fulfilling short-term goals. Instead, look at vehicles such as savings accounts and money market funds.

Dividends are payments made to an owner (unlike interest, which is payments to a creditor). Dividends are a great source of income, and companies that issue dividends tend to have more stable stock prices as well. The Canadian government offers a dividend tax credit, which comes to Canadian taxpayers from Canadian companies paying dividends. (Refer to Chapter 5 in Book IV for more about this credit.)

Table 3-1 gives you general guidelines, but keep in mind that not everyone can fit into a particular profile. Every Canadian investor has a unique situation, set of goals, and level of risk tolerance. Remember that the terms *large cap, mid cap,* and *small cap* refer to the size (or *market capitalization,* also known as *market cap*) of the company. All factors being equal, large companies are safer (less risky) than small companies. For more on market caps, see the section "Investing for Your Personal Style" in this chapter.

Investing by Time Frame

Are your goals long-term or short-term? Answering this question is important because individual stocks can be either great or horrible choices, depending on the time period you want to focus on. Generally, the length of time you plan to invest in stocks can be short-term, intermediate-term, or long-term. The following sections outline what kinds of stocks are most appropriate for each term length.

Investing in stocks becomes less risky as the time frame lengthens. Stock prices tend to fluctuate on a daily basis, but they have a tendency to trend up or down over an extended period of time. Even if you invest in a stock that goes down in the short term, you're likely to see it rise — and possibly go above your initial investment — if you have the patience to wait it out and let the stock price appreciate.

Focusing on the short term

Short term generally means one year or less, although some people extend the period to two years or less. You get the point.

Everyone has short-term goals. Some are modest, such as setting aside money for an exciting vacation in Barbados this year or paying for unwelcome medical bills. Other short-term goals are more ambitious, such as accruing funds for a down payment to purchase a new home within six months. Whatever the expense or purchase, you need a predictable accumulation of cash soon. If this sounds like your situation, stay away from the stock market!

Because stocks can be so unpredictable in the short term, they're a bad choice for short-term considerations. We continue to marvel in disbelief whenever we hear slick market analysts saying things like, "At $25 a share, XYZ is a solid investment, and we feel that its stock should hit our target price of $40 within six to nine months." You just know someone will hear that and say, "Gee, why bother with 3 percent at the bank when this stock will rise by more than 50 percent? I better call my broker." The stock may indeed hit that target amount (or even surpass it), or it may not. Most of the time, the stock doesn't reach the target price, and then the investor is disappointed. The stock could even go down! The reason why target prices are frequently (usually) missed is that the analyst is only one person and it's difficult to figure out what millions of investors will do in the short term. The short term can be irrational because so many investors have so many reasons for buying and selling that it's difficult to analyze. If you want to use the money you invest for an important short-term need, you could lose very important cash quicker than you think.

Short-term stock investing is very unpredictable. You can better serve your short-term goals with stable, interest-bearing investments such as guaranteed investment certificates (GICs) and certificates of deposit (CDs) available at chartered banks, or Treasury bills and short-term government bonds available at investment dealers.

During the raging bull market of the late 1990s, investors watched as some high-profile stocks went up 20 to 50 percent in a matter of months. Hey, who needs a savings account earning a measly interest rate when stocks grow like that! Of course, when the bear market hit in 2000 and those same stocks fell 50 to 90 percent, a savings account earning a measly interest rate suddenly didn't seem so bad.

Stocks — even the best ones — fluctuate in the short term. In a negative environment, they can be very volatile. No one can accurately predict the price movement (unless you have some inside information, which might be illegal), so stocks are definitely inappropriate for any financial goal you need to reach within one year. Revisit Table 3-1 for suggestions about your short-term strategies.

Considering intermediate-term goals

Intermediate term refers to your financial goals you plan to reach within five years. If, for example, you want to accumulate funds to put money down for investing in real estate four years from now, some growth-oriented investments may be suitable.

Although some stocks *may* be appropriate for a two- or three-year time period, not all stocks are good intermediate-term investments. Different types and categories of stocks exist. Some stocks are fairly stable and hold their value well, such as the stock of very large or established dividend-paying companies. Other stocks have prices that jump all over the place, such as the stocks of untested companies that haven't been in existence long enough to develop a consistent track record.

If you plan to invest in the stock market to meet intermediate-term goals, consider large, established companies or dividend-paying companies in industries that provide the necessities and essentials of life (like food, banking, beverages, or utilities).

Preparing for the long term

Stock investing is best suited for making money over a long period of time. When you measure stocks against other investments in terms of five to (preferably) ten or more years, they excel. Even investors who bought stocks during the depths of the Great Depression saw profitable growth in their stock portfolios over a ten-year period.

In fact, if you examine any ten-year period over the past 70 years, you see that stocks almost always beat out other financial investments — such as bonds or bank deposits — when measured by total return (taking into account reinvesting and the compounding of capital gains and dividends). As you can see, long-term planning allows stocks to shine. Of course, your work doesn't stop at deciding on a long-term investment. You still have to do your homework and choose stocks wisely because, even in good times, you can lose money if you invest in companies that go out of business.

Because you can choose among many different types and categories of stocks, virtually any investor with a long-term perspective should add stocks to his or her investment portfolio. Whether you want to save for your child's university fund or for future retirement goals, carefully selected stocks have proven to be a superior long-term investment for multitudes of Canadians.

Investing for a Purpose

When the lady was asked why she bungee jumped off the bridge that spanned a massive ravine, she answered, "Because it's fun!" When someone asked the fellow why he dove into a pool chock-full of alligators and snakes, he responded, "Because someone pushed me." Your investment in stocks shouldn't happen unless you have a purpose you understand, like investing for growth or investing for income. Even if an adviser pushes you to invest, be sure your adviser gives you an explanation of how that stock choice fits your purpose before you dive in.

We know of a very nice, elderly lady who had a portfolio brimming with aggressive-growth stocks because she had an overbearing broker. Her purpose should've been conservative, and she should've chosen investments that would preserve her wealth rather than grow it. Obviously, the broker's agenda got in the way. Stocks are just a means to an end. Figure out your desired end and then match the means.

Making loads of money quickly: Growth investing

When investors want their money to grow, they look for investments that appreciate in value. *Appreciate* is just another way of saying "grow." If you have a stock you bought for $8 per share and now its value is $30 per share, your investment has grown by $22 per share — that's appreciation. We know we would appreciate it!

Appreciation (also known as *capital gain*) is probably the number-one reason why people invest in stocks. Few investments have the potential to grow your wealth as conveniently as stocks.

Stocks are a great way to grow your wealth, but they're not the only way. Many investors seek alternative ways to make money, but many of these alternative ways are more aggressive and carry significantly more risk. You may have heard about people who made quick fortunes in areas such as commodities (like wheat, pork bellies, or precious metals), options, and other more sophisticated investment vehicles. If you're just starting out, limit risky investments to only a small portion of your portfolio, such as 10 percent of your investable funds. Experienced investors, however, can go as high as 20 percent.

Steadily making money: Income investing

Not all investors want to take on the risk that comes with making a killing. (Hey . . . no guts, no glory!) Some people just want to invest in the stock market as a means of providing a steady income. They don't need stock values to go through the ceiling. Instead, they need stocks that perform well consistently.

If your purpose for investing in stocks is to create income, choose stocks that pay dividends. Dividends are typically paid quarterly to shareholders on record.

Distinguishing between dividends and interest

Don't confuse dividends with interest. Most people are familiar with interest, because that's how you grow your money over the years in the bank. The important difference is that interest is paid to creditors, and dividends are paid to owners (meaning shareholders — and if you own stock, you're a shareholder, because stocks represent shares in a publicly traded company).

When you buy stock, you buy a piece of that company. When you put money in a bank (or when you buy bonds), you basically loan your money. You become a creditor, and the bank or bond issuer is the debtor and, as such, must eventually pay your money back to you with interest.

Recognizing the importance of an income stock's yield

Investing for income means you have to consider your investment's yield. If you want income from a stock investment, you must compare the yield from that particular stock with alternatives. Looking at the yield is a way to compare the income you expect to receive from one investment with the expected income from others. Table 3-2 shows some comparative yields.

Table 3-2 Comparing the Yields of Various Investments

Investment	*Type*	*Amount*	*Pay Type*	*Payout*	*Yield*
Smith Co.	Stock	$50.00/share	Dividend	$2.50	5.00%
Jones Co.	Stock	$100.00/ share	Dividend	$4.00	4.00%
Acme Bank	GIC	$500.00	Interest	$25.00	5.00%
Acme Bank	GIC	$2,500.00	Interest	$131.25	5.25%
Acme Bank	GIC	$5,000.00	Interest	$287.50	5.75%
Brown Co.	Bond	$5,000.00	Interest	$300.00	6.00%

To understand how to calculate yield, you need the following formula:

Yield = Payout ÷ Investment amount

Yield enables you to compare how much income you would get from a prospective investment with how much income you would get from other investments. For the sake of simplicity, this exercise is based on an annual percentage yield basis (compounding would increase the yield).

Jones Co. and Smith Co. are both typical dividend-paying stocks and, in the example presented by Table 3-2, we presume that both companies are similar in most respects except for their differing dividends. How can you tell whether a $50 stock with a $2.50 annual dividend is better (or worse) than a $100 stock with a $4.00 dividend? The yield tells you.

Even though Jones Co. pays a higher dividend ($4.00), Smith Co. has a higher yield (5 percent). Therefore, if you had to choose between those two stocks as an income investor, you would choose Smith Co. Of course, if you truly want to maximize your income and don't really need your investment to appreciate a lot, you'd probably choose Brown Co.'s bond because it offers a yield of 6 percent. (Don't forget, it's the after-tax yield you really need to examine.)

Dividend-paying stocks do have the ability to increase in value. They may not have the same growth potential as growth stocks, but, at the very least, they have a greater potential for capital gain than GIC or bonds.

Investing for Your Personal Style

Your investing style isn't a blue-jeans-versus-three-piece-suit debate. It refers to your approach to stock investing. Do you want to be conservative or aggressive or balanced? Would you rather be the tortoise or the hare or a little bit of both? Your investment personality greatly depends on the term over which you're planning to invest and on your purpose (refer to the previous two sections in this chapter). The following sections outline the two most general investment styles.

Conservative investing

Conservative investing means you put your money in something proven, tried, and true. You invest your money in safe and secure places, such as chartered banks and government-backed securities. But how does that apply to stocks? (Table 3-1 gives you suggestions.)

Conservative stock investors want to place their money in companies that exhibit some of the following qualities:

- **Proven performance:** You want companies that show increasing sales and earnings year after year. You don't demand anything spectacular, just a strong and steady performance.
- **Market size:** Companies should be *large cap* (short for large capitalization). In other words, they should have a market value exceeding $10 billion in size. Conservative investors surmise that bigger is safer.
- **Market leadership:** Companies should be leaders in their industries.
- **Perceived staying power:** You want companies with the financial clout and market position to weather uncertain market and economic conditions. It shouldn't matter what happens in the economy or who gets elected prime minister.

As a conservative investor, you don't mind if the companies' share prices jump (who would?), but you're more concerned with steady growth over the long term.

Aggressive investing

Aggressive investors can plan over the long term or look only to the intermediate term, but in any case, they want stocks that resemble Aesop's fabled hare — they show the potential to break out of the pack.

Aggressive stock investors want to invest their money in companies that exhibit some of the following qualities:

- **Great potential:** The company must have superior goods, services, ideas, or ways of doing business compared to their competition.
- **Capital gains possibility:** You don't even consider dividends. If anything, you dislike dividends. You feel the money that would've been dispensed in dividend form is better reinvested in the company. This, in turn, can spur greater growth.
- **Innovation:** Companies should have technologies, ideas, or innovative methods that make them stand apart from other companies.

Aggressive investors usually seek out small capitalization stocks, known as small caps, because they have plenty of potential for growth. Take the tree example, for instance: A giant redwood may be strong but may not grow much more, whereas a brand-new sapling has plenty of growth to look forward to. Why invest in stodgy, big companies when you can invest in smaller enterprises that may become the leaders of tomorrow? Aggressive investors have no problem investing in obscure companies because they hope that such companies will become another IBM, Canadian National Railway Company, or McDonald's.

Investing by personal time frames, objectives, and style is not done in isolation. After you've calibrated and determined your *personal* investing style, you still have to consider the fundamentals of the *company* you may invest in. In other words, personal investing styles are about you; fundamentals are about the company. Fundamental investing principles are covered throughout this book, including the importance of a company's financial condition, its industry, and its risk profile. Fundamental investing is done *in tandem* with investing by time frames, objectives, and style.

Chapter 4

Before You Get Started with Stocks

In This Chapter

- Deciphering stock tables
- Interpreting dividend news
- Finding out what brokers do
- Distinguishing between full-service and discount brokers
- Selecting a broker
- Looking at online brokers
- Exploring the types of brokerage accounts

Knowledge and information are two critical success factors in stock investing. (Isn't that true about most things in life?) People who plunge headlong into stocks without sufficient knowledge of the stock market in general — and current information in particular — quickly learn the lesson of the eager diver who didn't find out ahead of time the pool was only an inch deep. (Ouch!) In their haste to avoid missing so-called golden investment opportunities, investors too often end up losing money.

No such thing as a single (and fleeting) magical moment exists, so don't feel that if you let an opportunity pass by you'll always regret missing your one big chance. For the best approach to stock investing, you want to build your knowledge and find quality information first. Then buy stocks and make your fortunes more assuredly. Basically, before you buy stock, you need to know that the company you're investing in is

- Financially sound and growing
- In a strong and growing industry (and general economy)
- Offering products and services in demand by consumers

Where do you start and what kind of information do you want to acquire? Keep reading.

Reading (And Understanding) Stock Tables

The stock tables in major business publications, such as *The Globe and Mail* and the *National Post,* are no longer loaded with information that can help you become a savvy investor (*if* you know how to interpret it). For this information, go to the newspaper Web sites or *The Wall Street Journal* and *Investor's Business Daily*. You need the information in the stock tables for more than selecting promising investment opportunities, and you also need to consult the tables to monitor how your stocks are doing after you invest. If you bought HokySmoky common stock last year at $12 per share and you want to know what it's worth today, check out the stock tables.

If you look at the stock tables without knowing why you're looking or what you're looking at, it's the equivalent of reading *War and Peace* backward through a kaleidoscope. Nothing makes sense. But we can help you make sense of it all (well, at least the stock tables!). Table 4-1 shows a sample stock table to refer to as you read the following sections.

Table 4-1 Deciphering Stock Tables

52-Wk High	*52-Wk Low*	*Name (Symbol)*	*Div*	*Vol*	*Yld*	*P/E*	*Close*	*Net Chg*
21.50	8.00	SkyHighCorp (SHC)		3,143		76	21.25	+.25
47.00	31.75	LowDownInc (LDI)	2.35	2,735	5 9	18	41.00	–.50
25.00	21.00	ValueNowInc (VNI)	1.00	1,894	4.5	12	22.00	+.10
83.00	33.00	DoinBadlyCorp (DBC)		7,601			33.50	–.75

Every newspaper's financial tables are a little different, but they give you basically the same information at their Web site. This section is not the place to start your search for a good stock; in fact, it's usually where your search ends. The stock tables are the place to look when you already know what you want to buy and you're just checking to see the most recent price (they're updated daily), or when you already own a stock and want to check the latest price.

Each item gives you some clues about the current state of affairs for that particular company. The sections that follow describe each column to help you understand what you're looking at.

52-week high

The column labelled "52-Wk High" (refer to Table 4-1) gives you the highest price that particular stock has reached in the most recent 52-week period. Knowing this price lets you gauge where the stock is now versus where it has been recently. SkyHighCorp's (SHC) stock has been as high as $21.50, while its last (most recent) price is $21.25, the number listed in the "Close" column. (Flip to the "Close" section for more on understanding this information.) SkyHighCorp's stock is trading very high right now because it's hovering right near its overall 52-week-high figure.

Now, take a look at DoinBadlyCorp's (DBC) stock price. It seems to have tumbled big time. Its stock price has had a high in the past 52 weeks of $83, but it's currently trading at $33.50. Something just doesn't seem right here. During the past 52 weeks, DBC's stock price fell dramatically. If you're thinking about investing in DBC, find out why the stock price fell. If the company is a strong company, it may be a good opportunity to buy stock at a lower price. If the company is having tough times, avoid it. In any case, research the company to find out why its stock has declined.

52-week low

The column labelled "52-Wk Low" gives you the lowest price that particular stock reached in the most recent 52-week period. Again, this information is crucial to your ability to analyze a stock over a period of time. Look at DBC in Table 4-1, and you can see that its current trading price of $33.50 is close to its 52-week low.

Keep in mind that the high and the low prices just give you a range of how far that particular stock's price has moved within the past 52 weeks. They could alert you that a stock has problems, or they could tell you a stock's price has fallen enough to make it a bargain. Simply reading the "52-Wk High" and "52-Wk Low" columns isn't enough to determine which of those two scenarios is happening. They basically tell you to get more information before you commit your money.

Name and symbol

The "Name (Symbol)" column is the simplest in Table 4-1. It tells you the company name (usually abbreviated) and the stock symbol assigned to the company. When you have your eye on a stock for potential purchase, get familiar with its symbol. Knowing the symbol makes it easier for you to find your stock in the financial tables, which list stocks in alphabetical order by the company's name. Stock symbols are the language of stock investing, and you need to use them in all stock communications — from getting a stock quote at your broker's office to buying stock over the Internet.

Dividend

Dividends (shown under the "Div" column in Table 4-1) are basically payments to owners (shareholders). If a company pays a dividend, it's shown in the dividend column. The amount you see is the annual dividend quoted for one share of that stock. If you look at LowDownInc (LDI) in Table 4-1, you can see that you get $2.35 as an annual dividend for each share of stock you own. Companies usually pay the dividend in quarterly amounts. If someone owns 100 shares of LDI, the company pays that person a quarterly dividend of $58.75 ($235 total per year). A healthy company strives to maintain or upgrade the dividend for shareholders from year to year. In any case, the dividend is very important to investors seeking income from their stock investment. Investors buy stock in companies that don't pay dividends primarily for growth.

Volume

Normally, when you hear the word *volume* on the news, it refers to how much stock is bought and sold for the entire market. ("Well, stocks were very active today. Trading volume at the New York Stock Exchange hit 2 billion shares.") Volume is certainly important to watch because the stocks you're investing in are somewhere in that activity. For the "Vol" column in Table 4-1, though, the volume refers to the individual stock.

Volume tells you how many shares of that particular stock were traded that day. If only 100 shares are traded in a day, then the trading volume is 100. SHC had 3,143 shares change hands on the trading day represented in Table 4-1. Is that good or bad? Neither, really. Usually the business news media mention volume for a particular stock only when it's unusually large. If a stock normally has volume in the 5,000–10,000 range and all of a sudden has a trading volume of 87,000, then it's time to sit up and take notice.

Keep in mind that a low trading volume for one stock may be a high trading volume for another stock. You can't necessarily compare one stock's volume against that of any other company. The large-cap stocks like Canadian National Railway Company or Microsoft typically have trading volumes in the millions of shares almost every day. Less active, smaller stocks may have average trading volumes in far, far smaller numbers.

The main point to remember is that a trading volume far in excess of that stock's normal range is a sign something is going on with that stock. It may be negative or positive, but something newsworthy is happening with that company. If the news is positive, the increased volume is a result of more people buying the stock. If the news is negative, the increased volume is probably a result of more people selling the stock. What are typical events that cause increased trading volume? Some positive reasons include the following:

- **Good earnings reports:** A company announces good (or better-than-expected) earnings.
- **New business deal:** A company announces a favourable business deal, such as a joint venture, or lands a big client.
- **New product or service:** A company's research and development department creates a potentially profitable new product.
- **Indirect benefits:** A company may benefit from a new development in the economy or from a new law passed by Parliament.

Some negative reasons for an unusually large fluctuation in trading volume for a particular stock include the following:

- **Bad earnings reports:** Profit is the lifeblood of a company. When a company's profits fall or disappear, you see more volume.
- **Governmental problems:** The stock is being targeted by government action (such as a lawsuit or a U.S. Securities and Exchange Commission probe).
- **Liability issues:** The media report that a company has a defective product, or similar problem.
- **Financial problems:** Independent analysts report that a company's financial health is deteriorating.

Check out what's happening when you hear about heavier-than-usual volume (especially if you already own the stock).

Yield

In general, yield is a return on the money you invest. However, in the stock tables, *yield* ("Yld" in Table 4-1) is a reference to what percentage of the stock price that particular dividend is. Yield is most important to income investors. It's calculated by dividing the annual dividend by the current stock price. In Table 4-1, you can see that the yield du jour of ValueNowInc (VNI) is 4.5 percent (a dividend of $1 divided by the company's stock price of $22). Notice that many companies have no yield reported; because they have no dividends, yield is zero.

Keep in mind that the yield reported in the financial pages changes daily as the stock price changes. Yield is always reported as if you're buying the stock that day. If you buy VNI on the day represented in Table 4-1, your yield is 4.5 percent. But what if VNI's stock price rises to $30 the following day? Investors who buy stock at $30 per share obtain a yield of just 3.3 percent. (The dividend of $1 is now divided by the new stock price, $30.) Of course, because you bought the stock at $22, you essentially locked in the prior yield of 4.5 percent. Lucky you. Pat yourself on the back.

P/E ratio

The *P/E ratio* ("P/E" in Table 4-1) is the ratio between the price of the stock and the company's earnings. P/E ratios are widely followed and are important barometers of value in the world of stock investing. The P/E ratio (also called the earnings multiple, or just "multiple") is frequently used to determine whether a stock is expensive (a good value). Value investors (such as ourselves) find P/E ratios to be essential to analyzing a stock as a potential investment. As a general rule, the P/E should be 10–20 for large-cap or income stocks. For growth stocks, a P/E no greater than 30–40 is preferable.

In the P/E ratios reported in stock tables, *price* refers to the cost of a single share of stock. *Earnings* refers to the company's reported earnings per share as of the most recent four quarters. The P/E ratio is the price divided by the earnings. In Table 4-1, VNI has a reported P/E of 12, which is considered a low P/E. Notice how SHC has a relatively high P/E of 76. This stock is considered too pricey because you're paying a price equivalent to 76 times earnings. Also notice that DBC has no available P/E ratio. Usually this lack of a P/E ratio indicates the company reported a loss in the most recent four quarters.

Close

The "Close" column tells you how trading ended for a particular stock on the day represented by the table. In Table 4-1, LDC ended the most recent day of trading at $41. Some newspapers report the high and low for that day in addition to the stock's closing price for the day.

Net change

The number in the "Net Chg" column answers the question "How did the stock price end today compared with its trading price at the end of the prior trading day?" Table 4-1 shows that SHC stock ended the trading day up 25 cents (at $21.25). The "Net Chg" column also lets you figure out that SHC ended the prior day at $21. On a day when VNI ends the day at $22 (up 10 cents), you can tell that the prior day it ended the trading day at $21.90.

Understanding Why Closing and Dividend Dates Matter

Reading and understanding the news about dividends is essential if you're an income investor (someone who invests in stocks as a means of generating regular income). Paying particular attention to important dividend dates helps you benefit as an investor.

To begin, be aware that three business days fall between the date of execution of a trade and the closing, or settlement, date. The closing or settlement date is the date on which the trade is finalized, usually three business days after execution. This is the official date on which you buy or sell your stock.

Three business days fall between the ex-dividend date and the date of record (the date by which you have to be an official owner of the stock). This information is important to know if you want to qualify to receive an upcoming dividend. Timing is important, and the following example is the best way to explain it.

Say you want to buy ValueNowInc (VNI) in time to qualify for the quarterly dividend of 25 cents per share. Assume the date of record is February 10. You have to execute the trade (buy the stock) no later than February 7 to be assured of receiving the dividend. If you execute the trade right on February 7, the closing date would occur three days later, on February 10 — just in time for the date of record.

But what if you execute the trade on February 8, a day later? Well, the trade's closing date would be February 11, which would occur *after* the date of record. Because you wouldn't be on the books as an official shareholder on the date of record, you wouldn't get that quarterly dividend. In this example, the February 7–10 period is called the ex-dividend period.

Going for Brokers

When you're ready to dive in and start investing in stocks, you first have to choose a broker. It's kind of like buying a car: You can do all the research in the world and know exactly what kind of car you want to buy; still, you need a venue to do the actual transaction. Similarly, when you want to buy stock, your task is to do all the research you can to select the company you want to invest in. Still, you need a broker to actually buy the stock, whether you buy over the phone or online.

The broker's primary role is to serve as the agent through which you either buy or sell stock. When we talk about brokers, we're referring to organizations such as TD Waterhouse, E*TRADE Canada, HSBC InvestDirect, and many others that can buy stock on your behalf. Brokers can also be individuals who work for such firms. Although you can buy some stocks directly from the company that issues them, to purchase most stocks, you still need a broker or investment adviser.

The primary task of brokers is the buying and selling of securities (keep in mind the word *securities* refers to the world of financial or paper investments, and stocks are only a small part of that world), such as stocks. But they can also perform other tasks for you, including the following:

- **Providing advisory services:** Investors pay brokers a fee for investment advice. Customers also get access to the firm's research.
- **Offering limited banking services:** Brokers can offer banking features like interest-bearing accounts, cheque writing, and direct deposit.
- **Brokering other securities:** Brokers can also buy bonds, mutual funds, options, exchange-traded funds, and other investments on your behalf.

Personal stockbrokers make their money from individual investors like you through various fees, including these:

- **Brokerage commissions:** These fees are for buying and/or selling stocks and other securities.
- **Margin interest charges:** Interest is charged to investors for borrowing against their brokerage account for investment purposes.
- **Service charges:** These charges are for performing administrative tasks and other functions. Brokers charge fees to investors for administering registered retirement savings plans (RRSPs), for mailing stocks in certificate form, and for other special services.

The distinction between personal stockbrokers and institutional stockbrokers is important. Institutional brokers make money from institutions and companies through investment banking and securities placement fees (such as initial public offerings and secondary offerings), advisory services, and other broker services. Personal stockbrokers generally offer the same services to individuals and small businesses.

Distinguishing between Full-Service and Discount Brokers

Stockbrokers fall into two basic categories: full-service and discount. The type you choose really depends on what type of investor you are. In a nutshell, full-service brokers are suitable for investors who need some guidance. Discount brokers are better for those investors who are sufficiently confident and knowledgeable about stock investing to manage with minimal help.

Full-service brokers

Full-service brokers are just what the name indicates. They try to provide as many services as possible for investors who open accounts with them. When you open an account at an investment dealer, a representative is assigned to your account. The firm usually calls this representative an investment adviser, a registered rep, or a financial consultant. This person usually has a securities licence and is knowledgeable about stocks in particular and investing in general.

Some of Canada's full-service brokers include HSBC Securities, RBC Dominion Securities, and TD Waterhouse Private Investment Advice. Of course, all brokers now have full-feature Web sites to give you further information about their services. Get as informed as possible before you open your full-service account. A full-service broker should be there to help make your fortune, not to help make you . . . uh . . . broker.

What they can do for you

Your investment adviser is responsible for assisting you, answering questions about your account and the securities in your portfolio, and transacting your buy and sell orders. Here are some things full-service brokers can do for you:

- **Offer guidance and advice:** The greatest distinction between full-service brokers and discount brokers is the personal attention you receive from your investment adviser. You get to be on a first-name basis with a full-service adviser, and you disclose much information about your finances and financial goals. The adviser is there to make recommendations about stocks, mutual funds, bonds, and T-bills that are likely suitable for you.
- **Provide access to research:** Full-service investment advisers can give you access to their investment research department, which can give you in-depth information and analysis on a particular company. This information can be very valuable, but be aware of the pitfalls.
- **Help you achieve your investment objectives:** Beyond advice on specific investments, a good adviser gets to know you and your investment goals and *then* offers advice and answers your questions about how specific investments and strategies can help you accomplish your wealth-building goals.
- **Make investment decisions on your behalf:** Many investors don't want to be bothered when it comes to investment decisions. Full-service advisers can actually make decisions for your account with your authorization. This service is fine, but insist on a reasonable explanation of their choices.

What to watch out for

Although the full-service advisers — with their seemingly limitless assistance — can make life easy for an investor, you need to remember some important points to avoid problems:

- **Investment advisers are still salespeople.** Most are honest; some are complete shills. No matter how well they treat you, they're still compensated based on their ability to produce revenue for the investment dealer. They generate commissions and fees from you on behalf of the company. (In other words, they're paid to sell you things.) Some advisers are paid to manage your money by charging annual fees rather than commissions on every purchase and sale in your portfolio.
- **Some advisers don't give clear reasons for their decisions.** Once again, it is critical that whenever your adviser makes a suggestion or recommendation, you ask why and request a complete answer that includes the reasoning behind the recommendation. A good adviser is able to clearly explain the reasoning behind every suggestion. If you don't fully understand and agree with the advice, don't take it.

- **Full-service advisers can be costly.** Working with a full-service adviser costs more than working with a discount broker. Discount brokers are paid simply for performing the act of buying or selling stocks for you. Full-service advisers do that and more. Additionally, they provide advice and guidance. Because of that, full-service advisers are more expensive (higher brokerage commissions and advisory fees). Also, most full-service advisers expect you to invest at least $5,000 to $10,000 just to open an account. Full-service advisers can offer discounts on fees and commissions (if they're in a good mood).
- **Some advisers make bad decisions for you.** Handing over decision-making authority to your adviser can be a possible negative because letting others make financial decisions for you is always dicey — especially when they're using *your* money. If they make poor investment choices that lose you money, you may not have any recourse because you authorized them to act on your behalf.
- **Some advisers engage in an activity called churning.** Churning is basically buying and selling stocks for the sole purpose of generating commissions. Churning is great for advisers but bad for customers. If your account shows a lot of activity, ask for justification, especially if no profits occur for you. Commissions, especially those charged by full-service advisers, can take a big bite out of your wealth. Don't tolerate churning or any other suspicious activity.

Discount brokers

Perhaps you don't need any hand holding from an adviser. You know what you want, and you can make your own investment decisions. All you want is someone to transact your buy/sell orders. In that case, go with a discount broker. They don't offer advice or premium services — just the basics required to perform your stock transactions.

Discount brokers, as the name implies, are cheaper to engage than full-service advisers. Because you're advising yourself (or getting advice from third parties such as newsletters or independent advisers), you can save on the costs you incur when you pay for a full-service adviser.

If you choose to work with a discount broker, you must know as much as possible about your personal goals and needs. You have a greater responsibility for conducting adequate research to make good stock selections. You must be prepared to accept the outcome, whatever that outcome may be.

For a while, the regular investor had two types of discount brokers to choose from: conventional discount brokers and Internet discount brokers. But the two are so similar now the differences are hardly worth mentioning. Conventional discount brokers (such as TD Waterhouse and ScotiaMcLeod Direct Investing) primarily conducted business through regular offices and over the phone. Internet discount brokers (like E*TRADE Canada being taken over during July 2008 by the Bank of Nova Scotia who also owns ScotiaMcLeod Direct) conducted business primarily through Web sites. But through industry consolidation, most of the conventional discount brokers today have fully featured Web sites. Internet discount brokers adapted by adding more telephone and face-to-face services to their businesses. (We discuss online brokerage services in detail later in this chapter.)

What they can do for you

Discount brokers offer some significant advantages over full-service advisers, such as

- **Lower cost:** This lower cost is usually the result of lower commissions, and it's the primary benefit of using discount brokers.
- **Unbiased service:** Discount brokers offer you the ability to transact your stock buy/sell orders only. Because they don't offer advice, they have no vested interest in trying to sell you any particular stock or mutual fund.
- **Access to information:** Established discount brokers offer extensive educational materials at their offices or on their Web sites.

What to watch out for

Of course, doing business with discount brokers also has its downside, including the following:

- **No guidance:** Because you've chosen a discount broker, you *know* not to expect guidance, but the broker should make this fact clear to you anyway. If you're a knowledgeable investor, the lack of advice is considered a positive thing — no interference.
- **Hidden fees:** Discount brokers may shout about their lower commissions, but commissions aren't their only way of making money. Many discount brokers charge extra for services you may think are included, such as issuing a stock certificate or mailing a statement. Ask whether they charge fees for maintaining RRSPs or fees for transferring stocks and other securities (such as bonds) in or out of your account. Find out what interest rates they charge for borrowing through brokerage accounts.
- **Minimal customer service:** If you deal with a Canadian Internet brokerage firm, find out about its customer service capability. If you can't transact business on its Web site, find out where you can call for assistance with your order.

Choosing a Broker

Before you choose a broker, you must resolve a few issues. The first issue is the broker's hair colour. Okay, okay, we'll stop the cheap jokes. Really, when you've decided whether to go the full-service or discount broker (conventional or Internet-centric) route, make sure you select a reputable investment firm. Look for one that's a member in good standing of one of Canada's self-regulatory organizations, or SROs. With big-name investment dealers you recognize, this is no big problem — all are probably in good standing. But with smaller dealers you need to check this out, and we show you where to go to do this. Another thing to do before choosing a broker is to assess and revisit your personal investing style, something we help you do in Chapter 3. We discuss both issues next.

Finding self-regulatory organizations (SROs) in Canada

Canadian stock exchanges and the Investment Industry Regulatory Organization of Canada (IIROC) represent Canada's key SROs. An SRO has been provided with legislated authority and the responsibility to regulate its member firms. They ensure SRO members meet standards governing stocks and other securities. SROs regulate markets and trading as well as firms that are members, their employees, and their business practices. They do this by establishing rules regulating how stock markets must operate. They monitor and visit investment dealers on a periodic basis to ensure mandated rules of operation (such as those concerning solvency) are followed. Canada's SROs investigate suspected infractions by sending out investigators and compliance officers to review things a bit further when necessary.

The provincial securities commissions have a national group that works toward making securities regulations consistent and standardized across Canada. This group is called the Canadian Securities Administrators (CSA; `www.csa-acvm.ca`). They possess nowhere near the power wielded by the more independent regulators of U.S. stock markets. As a result, options and remedies to the Canadian individual stock investor are limited.

To find out if a firm is a member of an SRO, check out the Web sites (under Member Firms) of the Investment Dealers Association (`www.ida.ca`) or TSX (`www.tsx.com`). You can also contact these organizations the good old-fashioned way — by phone!

Revisiting your personal investing style

Before you choose, you need to analyze and reassess your personal investing style. When you know yourself and the way you invest, you can proceed to finding the kind of broker that fits your needs. It's almost like choosing shoes; if you don't know your size, you can't get a proper fit. (And if you get it wrong, you can be in for a really uncomfortable future.)

Consider Bob and Ed. Both men are knowledgeable, confident, and competent investors, so they each choose a discount broker — makes sense. Bob likes to trade stocks very frequently. Ed is a buy-and-hold type, but he likes to trade on margin. Trading on margin means using the stocks and other securities in your investment account as collateral to purchase more shares. Which discount broker is suitable for which investor?

Say two discount brokers exist, JumpCo and StayCo. JumpCo charges $9 per trade, and StayCo charges $25. However, when it comes to margin trading, JumpCo charges 10 percent, but StayCo usually charges a full percentage point lower.

In this example, JumpCo is better suited to Bob's style of investing, but StayCo is better for Ed. Because Bob likes to trade frequently, the commission charge makes it more economical. Ed will pay a higher commission, but he'll eventually make his money back through lower margin interest costs.

This example clearly illustrates how different investors can benefit by analyzing themselves and then choosing an appropriate discount broker.

Making the decision

When the time comes to choose a broker, keep the following points in mind:

- Match your investment style with an SRO-member brokerage firm that charges the least amount of money for the services you're likely to use most frequently.
- Compare all the costs of buying, selling, and holding stocks and other securities through a broker. Don't look only at commissions; compare other costs, too, such as margin interest and other service charges.
- Contact a few firms before making your selection. Ask them if they are currently seeking accounts like yours. Ask for and call a few references to find out about the broker's strengths and weaknesses.

- If you select the full-service-firm route, ask for a recommendation of one or more advisers at the investment dealer who would be appropriate to handle your account, and then interview them.
- Read articles that compare brokers in publications and newspapers such as *Canadian Business, The Globe and Mail,* and the *National Post.*

Your broker will influence your finances in a big way, so take the time to get to know your new financial friend to decide whether this is the right person for you.

If you do run into problems, turn to the CIPF. The Canadian Investor Protection Fund (CIPF) is overseen by the Canadian investment industry and provides coverage for Canadians making investments through its members. It insures investment accounts similar to the way the Canada Deposit Insurance Corporation (CDIC) insures bank accounts. CIPF covers a customer's general accounts — up to $1,000,000 — for losses related to securities, commodity and futures contracts, segregated insurance funds, and cash balances. However, the amount of cash losses you can claim as part of this limit is restricted, and other important coverage restrictions exist. Check out the CIPF Web site (`www.cipf.ca`) for full and detailed information. By the way — you aren't covered if the market corrects! When a market goes way higher or lower than it should, stock indexes naturally tend to fall or rise rapidly and then settle into a more "normal" state.

Investing is no more than the allocation of capital for use by an enterprise with the idea of achieving a suitable return. He or she who allocates capital best wins!

Researching Online Investing Services

Investing online has flourished for several reasons. Online investing, via a discount brokerage service (conventional or Internet-centric), lets you buy and sell stocks and other financial instruments using your personal computer and an Internet connection. As we mention earlier, discount brokers provide most online broker services, but traditional full-service advisers support online services as well. Several factors contribute to the popularity of online investing:

- **Information aplenty:** The Internet provides quick and easy access to raw investment information (such as a stock quote) as well as refined information (such as an adviser's analysis of a company, or other information services previously available only to investment professionals).

- **Lower commission rates:** By eliminating the need for advisers, online brokers can offer commission rates that are lower than offline brokers charge. For example, buying 500 shares of Bombardier through a traditional full-service adviser could cost you about $100 in commissions. Online, the cost is only about $35. Easy account access is another reason for the popularity of online investing. Online brokers conveniently provide you with access to your account and the ability to place orders anytime and anywhere in Canada (or abroad) as long as you have an Internet connection.
- **You're in charge:** Control of the investment process appeals to many investors. You can research a company, buy shares in it, monitor its progress, and chat with other shareholders in that company to hear their opinions.

Getting online trading services for less

As you may have guessed, no two online brokerage services are alike. Furthermore, individual brokerages may change their services and fees to keep pace with their competitors. To find the online broker that best meets your needs, investigate the prices, services, and features various brokers offer.

Make certain your brokerage doesn't charge you for services that are free elsewhere, or are hidden. Some hidden fees may include

- Fees to close your account
- Fees to withdraw funds from your trading account
- Higher fees for accepting odd-lot orders (orders that include increments of fewer than 100 shares)

Trading online at a discount

You can't measure broker service with a formula. You have to look at both financial and nonfinancial criteria.

Cost is one factor, as we just found out. Definitely look at how much each broker charges in commission at different volumes of trades. Also assess the quality of online trade execution by talking to others who use a service you are considering. Are real-time quotes available? Is research material available? What is the overall ease of use of the service? Does the broker provide online screening tools?

Product selection is another important factor. You want to be able to trade things like guaranteed investment certificates (GICs), gold and silver certificates, municipal bonds, futures, Canadian and foreign equities, and so on. A list of investment products to consider is provided later in this chapter.

Response time should be quick. Some online brokers boast trade execution times of less than nine seconds! Phone each firm to see how long it takes for the broker to respond. E-mail each broker under consideration with a few questions; ask for an application to be sent by mail. Again, evaluate the response time.

Table 4-2 lists several discount brokerage services in Canada.

Table 4-2 You Can Trade at a Discount

	Minimum Online Trade Fee	*Minimum Automated Telephone Trade Fee*	*Minimum Broker-Assisted Trade Fee*
BMO InvestorLine 1-800-387-7800 www.bmoinvestorline.com	$25 for up to 1,000 shares	$25 for up to 1,000 shares	$35 minimum price per trade
CIBC Investor's Edge 1-800-567-3343 www.investorsedge.cibc.com/ie/home.jsp	$25 for up to 1,000 shares	$25 for up to 1,000 shares	$50 minimum price per trade
Disnat 1-800-268-8471 www.disnat.com/indexen.asp	$29 for up to 1,000 shares	Not available	$45 on orders of up to $2,000
E*TRADE Canada 1-888-872-3388 www.canada.etrade.com	$19.99 minimum	Not available	Online trade fee plus $35
HSBC InvestDirect 1-866-865-4722 www.mlhsbc.ca	$29 for up to 1,000 shares	Not available	$35 minimum per trade
National Bank Discount Brokerage 1-800-363-3511 www.nbc.ca	$27.95 for up to 1,000 shares	Not available	$44.95 minimum per trade

(continued)

Table 4-2 *(continued)*

	Minimum Online Trade Fee	*Minimum Automated Telephone Trade Fee*	*Minimum Broker-Assisted Trade Fee*
RBC Direct Investing 1-800-769-2560 www.rbcdirectinvesting.com	$29.95 for up to 1,000 shares	$35 for up to 1,000 shares	$35 minimum per trade
ScotiaMcLeod Direct Investing 1-800-263-3430 www.scotiabank.com	$25.95 for up to 1,000 shares	$25.95 for up to 1,000 shares	$34.95 minimum per trade
TD Waterhouse 1-800-465-5463 www.tdwaterhouse.ca	$29 for up to 1,000 shares	$29.95 (Talk Broker) or $35 (TeleMax)	$43 minimum per trade
eNorthern 1-888-829-7929 www.enorthern.com	$24 (2.5 cents per share)	Regular commission plus $20	Not available

E*TRADE Canada is a great company and has been in the online trading business as long as anyone else. It will continue to be a leader in this space. But its parent company in the United States has been hurt badly by the credit crunch we describe in Chapter 1 of Book III. Therefore, don't put all of your investment dollars in the E*TRADE Canada basket. We're not trying to scare you — we're just being cautious and watching your back!

Considering the Types of Brokerage Accounts

After you start investing in the stock market, you have to somehow *pay* for the stocks you buy. Most brokerage firms offer investors several different types of accounts, each serving a different purpose. We present three of the most common types in the following sections. The basic difference boils

down to how particular brokers view your *creditworthiness* when it comes to buying and selling securities. If your credit isn't great, your only choice is a cash account. If your credit is good, you can open either a cash account or a margin account. After you qualify for a margin account, you can (with additional approval) upgrade it to do options trades.

To open an account, you have to fill out an application and submit a cheque or money order for at least the minimum amount required to establish an account.

Cash accounts

A cash account means just what you think it means. You must deposit a sum of money along with the new account application to begin trading. The amount of your initial deposit varies from broker to broker. Although some brokers have a minimum of $10,000, others let you open an account for as little as $75. Once in a while you may see a broker offering cash accounts with no minimum deposit, usually as part of a promotion. Qualifying for a cash account is usually easy as long as you have cash and a pulse.

With a cash account, your money has to be deposited in the account before the closing (or settlement) date for any trade you make. The closing occurs three business days after the date you make the trade (the date of execution).

In other words, if you call your broker on Monday, October 10, and order 50 shares of CashLess Corp. at $20 per share, then on Thursday, October 13, you better have $1,000 in cash sitting in your account (plus commission). Otherwise, the purchase might not go through.

If you have cash in a brokerage account, see whether the broker will pay you interest on the uninvested cash in it, and how much. Some offer a service in which uninvested money earns money market rates.

Margin accounts

A margin account gives you the ability to borrow money against the securities in the account to buy more stock. Because you have the ability to borrow in a margin account, you have to be qualified and approved by the broker. After you're approved, this new-found credit gives you more leverage so that you can buy more stock or do short-selling.

Why use margin? Margin is to stocks what mortgage is to buying real estate. You can buy real estate with 100 percent cash, but many times, using borrowed funds makes sense because you may not have enough money or you may prefer not to pay all cash. With margin, you could, for example, be able to buy $10,000 worth of stock with as little as $5,000 in cash (or securities owned) sitting in your account. This example assumes a 50 percent margin limit. The balance of the stock purchase is acquired using a loan (margin) from the brokerage firm.

For stock trading, the margin limit is usually 50 percent. (For very conservative stocks, the margin limit can be as high as 70 percent. Ask your broker to inform you about margin limits on a stock-by-stock basis.) The interest rate you pay varies depending on the broker, but most brokers generally charge a rate that's several percent higher than their own borrowing rate.

Option accounts

An option account gives you all the capabilities of a margin account (which in turn also gives you the capabilities of a cash account), plus the ability to trade options on stocks and stock indexes. To upgrade your margin account to an options account, your Canadian broker must by law ask you to sign a statement saying that you're knowledgeable about options and familiar with the risks associated with them.

Chapter 5

Buying and Selling Stocks

In This Chapter

- Looking at different types of trading orders
- Trading on margin to maximize profits
- Making sense of going short

Investment success isn't just about picking rising stocks; it's also about how you go about doing it. Frequently, investors think good stock picking means doing your homework and then making that buy (or sell). However, you can take it a step further to maximize profits (or minimize losses). As a stock investor, you can take advantage of techniques and services available through your standard investment account. (See Chapter 4 for more on brokerage accounts.) This chapter presents some of the best ways you can use these powerful techniques — useful whether you're buying or selling stock. In fact, if you retain nothing more from this chapter than the concept of *trailing stops* (see the section "Trailing stops"), you'll have gotten your money's worth. (Really!) In this chapter, we show you how to use these techniques to maximize your investing profit.

Checking Out Trading Orders

Orders you place with your adviser (a.k.a. your stockbroker in the good ol' days) neatly fit into two categories:

- Time-related orders
- Condition-related orders

Get familiar with both types of orders, because they're easy to implement and they're invaluable tools for wealth building and, more important, wealth saving!

Using a combination of orders helps you fine-tune your strategy so you can maintain greater control over your investments. Speak with your adviser about the different types of orders you can use to maximize the gains (or minimize the losses) from your stock investing activities. You also can read the investment dealer's policies on stock orders at the dealer's Web site.

Time-related orders

Time-related orders mean just that; the order has a time limit. Typically, you use these orders in conjunction with conditional orders. The two most common time-related orders are day orders and good-till-cancelled (GTC) orders.

Day orders

A day order is an order to buy a stock that expires at the end of that particular trading day. If you tell your broker, "Buy BYOB, Inc., at $37.50 and make it a day order," you mean you want to purchase the stock at $37.50. But if the stock doesn't hit that price, your order expires at the end of the trading day unfilled. Why would you place such an order? Maybe BYOB is trading at $39, but you don't want to buy it at that price because you don't believe the stock is worth it. Consequently, you have no problem not getting the stock that day.

When would you use day orders? It depends on your preferences and personal circumstances. We don't use day orders too often because few events cause us to say, "Gee, we'll just try to buy or sell between now and the end of today's trading action." However, you may feel you don't want a specified order to linger beyond today's market action. Perhaps you want to test a price. ("I want to get rid of stock A at $39 to make a quick profit, but it's currently trading at $37.50. However, I may change my mind tomorrow.") A day order is the perfect strategy to use in this case.

If you make any trade and don't specify time with the order, most (if not all) brokers automatically treat it as a day order.

Good-till-cancelled (GTC) orders

A good-till-cancelled (GTC) order is the most commonly requested order by investors. Although GTC orders are time-related, they're always tied to a condition, such as when the stock achieves a certain price. The GTC order means just what it says: The order stays in effect until it's transacted or until the investor cancels it. Although the order implies that it can run indefinitely, most brokers have a limit of 30 days. By that time, either the broker cancels the order or contacts you to see whether you want to extend it. Ask your broker about his or her particular policy.

A GTC order is usually coupled with conditional or condition-related orders. For example, say you want to buy ASAP Corp. stock but you don't want to buy it at the current price of $48 per share. You've done your homework on the stock, including looking at the stock's price-to-earnings ratio, price-to-book ratio, and so on. So you say, "Hey, this stock isn't worth $48 per share. I'd only buy it at $36 per share." You think the stock would make a good addition to your portfolio, but not at the current market price. (It's overpriced or overvalued, according to your analysis.) How should you proceed? Your best bet is to ask your broker to do a "GTC order at $36." This request means your broker will buy the shares if and when they hit the $36 mark (or until you cancel the order). Just make sure your account has the funds or margin available to complete the transaction by the settlement date.

GTC orders are very useful, so become familiar with your broker's policy on them. While you're at it, ask whether any fees apply. Many brokers don't charge for GTC orders because, if they happen to result in a buy (or sell) order, they generate a normal commission just as any stock transaction does. Other brokers may charge a small fee.

To be successful with GTC orders, you need to know the following information:

- **When you want to buy:** In recent years, people have had a tendency to rush into buying a stock without giving some thought to what they could do to get more for their money. Some investors don't realize the stock market can be a place for bargain-hunting consumers. If you're ready to buy a quality pair of socks for $16 in a department store but the sales clerk says those same socks are going on sale tomorrow for only $8, what would you do — assuming you're a cost-conscious consumer? Unless you're barefoot, you're probably better off waiting. The same point holds true with stocks.

  Say you want to buy SOX, Inc., at $26, but it's currently trading at $30. You think $30 is too expensive, but you're happy to buy the stock at $26 or lower. However, you have no idea whether the stock will move to your desired price today, tomorrow, next week, or even next month (or maybe never). In this case, a GTC order is appropriate.

- **When you want to sell:** What if you bought some socks at a department store and then you discovered they have holes (darn it!)? Wouldn't you want to get rid of them? Of course you would. If a stock's price starts to unravel, you want to be able to get rid of it, as well.

  Perhaps you already own SOX (at $25, for instance) but are concerned that market conditions may drive the price lower. You're not certain which way the stock will move in the coming days and weeks. In this case, a GTC order to sell the stock at a specified price is a suitable strategy. Because the stock price is $25, you may want to place a GTC order to sell it if it falls to $22.50 to prevent further losses. Again, in this example, GTC is the time frame, and it accompanies a condition (sell when the stock hits $22.50).

Condition-related orders

A condition-related order means the order is executed only when a certain condition is met. Conditional orders enhance your ability to buy stocks at a lower price, to sell at a better price, or to minimize potential losses. When stock markets become bearish or uncertain, conditional orders are highly recommended. A good example of a conditional order is a *limit order.* A limit order may say, "Buy Mojeski Corp. at $45." But if Mojeski Corp. isn't at $45 (this price is the condition), the order isn't filled.

Market orders

When you buy stock, the simplest type of order is a market order — an order to buy or sell a stock at the market's current best available price. It doesn't get any more basic than that.

Here's an example: Kowalski, Inc., is available at the market price of $10. When you call up your broker and instruct him to buy 100 shares "at the market," he'll implement the order for your account, and you pay $1,000 plus commission.

We say "current best available price" because the stock's price is constantly moving, and catching the best price can be a function of the broker's ability to process the stock purchase. For very active stocks, the price change can happen within seconds. It's not unheard of to have three brokers simultaneously place orders for the same stocks and get three different prices because of differences in the brokers' capabilities. (Some computers are faster than others.)

The advantage of a market order is that the transaction is processed immediately, and you get your stock without worrying about whether it hits a particular price. For example, if you buy Kowalski, Inc., with a market order, you know that by the end of that phone call (or Web site visit) you're assured of getting the stock. The disadvantage of a market order is that you can't control the price you pay for the stock. Whether you're buying or selling your shares, you may not realize the exact price you expect (especially if you're buying or selling a volatile stock).

Market orders get finalized in the chronological order in which they're placed. Your price may change because the orders ahead of you in line caused the stock price to rise or fall based on the latest events.

Stop orders (also known as stop-loss orders)

A stop order (or stop-loss order, if you own the stock) is a condition-related order that instructs the broker to sell a particular stock only when the stock reaches a particular price. It acts like a trigger, and the stop order converts to a market order to sell the stock immediately.

The stop-loss order isn't designed to take advantage of small, short-term moves in the stock's price. It's meant to help you protect the bulk of your money when the market turns against your stock investment in a sudden manner.

Say your Kowalski, Inc., stock rises to $20 per share, and you seek to protect your investment against a possible future market decline. A stop-loss order at $18 triggers your broker to sell the stock immediately if it falls to the $18 mark. In this example, if the stock suddenly drops to $17, it still triggers the stop-loss order, but the finalized sale price is $17. In a volatile market, you may not be able to sell at your precise stop-loss price. However, because the order automatically gets converted into a market order, the sale will be done, and you prevent further declines in the stock.

The main benefit of a stop-loss order is that it prevents a major decline in a stock you own. It's a form of discipline that's important in investing because it minimizes potential losses. You may find it agonizing to sell a stock that has fallen. If you don't sell, however, your stock may continue to plummet as you keep holding on while hoping for a rebound in the price.

Many investors set a stop-loss amount at about 10 percent below the market value of a stock. This percentage gives the stock some room to fluctuate, which most stocks tend to do on a day-to-day basis.

Trailing stops

Trailing stops are an important technique in wealth preservation for seasoned stock investors, and they can be one of your key strategies in using stop-loss orders. A trailing stop is a stop-loss order an investor actively manages by moving it up along with the stock's market price. The stop-loss order "trails" the stock price upward. As the stop-loss goes upward, it protects more and more of the stock's value from declining.

A real-life example may be the best way to help you understand trailing stops. Say you bought a stock at $25 per share. As soon as you finished buying it, you immediately told your broker to put a stop-loss order at $22 and to make it a good-till-cancelled (GTC) order. Think of what you did. In effect, you placed an ongoing (GTC) safety net under your stock. The stock can go as high as the sky, but if it should fall, the stock's price triggers a market order at $22. Your stock is automatically sold, minimizing your loss.

If your stock goes to $50 per share in a few months, you can call your broker, cancel the former stop-loss order at $22, and replace it with a new (higher) stop-loss order. You simply say, "Please put a new stop-loss order at $45 and make it a GTC order." This higher stop-loss price protects not only your original investment of $20 but also a big chunk of your profit as well. As time goes

by and the stock price climbs, you can continue to raise the stop-loss price and add GTC provisions. Now you know why it's called a trailing stop: It trails the stock price upward like a giant tail. All along the way, it protects more and more of your growing investment without limiting its upward movement.

William O'Neill, publisher and founder of *Investor's Business Daily,* advocates setting a trailing stop of 8 percent below your purchase price. That's his preference. Some investors who invest in very volatile stocks may put in trailing stops of 20 or 25 percent. Is a stop-loss order desirable or advisable in every situation? No. It depends on your level of experience, your investment goals, and the market environment. Still, stop-loss orders are appropriate in most cases, especially if the market seems uncertain (or if you do!).

A trailing stop is a stop-loss order you actively manage. The stop-loss order is good-till-cancelled (GTC), and it constantly trails the stock's price as it moves up. To successfully implement trailing stops, keep the following points in mind:

- **Remember that brokers usually don't place trailing stops for you automatically.** In fact, they won't (or shouldn't) place any type of order without your consent. Deciding on the type of order to place is your responsibility. You can raise, lower, or cancel a trailing stop order at will, but you need to monitor your investment when substantial moves occur to respond appropriately to the movement.
- **Change the stop-loss order when the stock price moves significantly.** Hopefully, you won't call your broker every time the stock moves 50 cents. Change the stop-loss order when the stock price moves about 10 percent. When you initially purchase the stock (say, at $90 per share), request that the broker place the stop-loss order at $81. When the stock moves to $100, cancel the $81 stop-loss order and replace it at $90. When the stock's price moves to $110, change the stop-loss order to $99, and so on.
- **Understand your broker's policy on GTC orders.** If your broker usually lets GTC orders expire after 30 days, be aware of it. You don't want to risk a sudden drop in your stock's price without the stop-loss order protection. If your broker's time limit is 30 days, note this so you can renew the order for additional time.
- **Monitor your stock.** A trailing stop isn't a set-it-and-forget-it technique. Monitoring your investment is critical. Of course, if your investment falls, the stop-loss order prevents further loss. Should the stock price rise substantially, remember to adjust your trailing stop accordingly. Keep raising the safety net as the stock continues to rise. Part of monitoring the stock is knowing the beta, which you can read more about in the next section.

Using beta measurement

To be a successful investor, you need to understand the volatility of the particular stock you invest in. In stock market parlance, this volatility is also called the beta of a stock. Beta is a quantitative measure of the volatility of a given stock (and mutual funds and portfolios, too) relative to the overall market, usually the S&P 500 Index. (For more information on U.S. and Canadian indexes, see Chapter 5 in Book IV.) Beta specifically measures the performance movement of a stock as the S&P moves 1 percent up or down. A beta measurement above 1 is more volatile than the overall market, while a beta below 1 is less volatile. Some stocks are relatively stable in their price movements; others jump around.

Because beta measures how volatile or unstable the stock's price is, it tends to be uttered in the same breath as "risk" — more volatility indicates more risk. Similarly, less volatility tends to mean less risk.

Table 5-1 shows some sample betas of well-known U.S. and Canadian companies (as of May 2008).

Table 5-1 Looking at Well-Known Betas

Company	*Beta*	*Comments*
Petro-Canada (PCA.TO)	0.766	A bit less volatile than the market. If the S&P/TSX Composite Index moves 10%, Petro-Canada only moves 7.87%.
JDS Uniphase (JDU)	2.32	Over two times more volatile than the market — typical for technology stocks.
Public Service Enterprise Group (PEG)	0.43	Statistically considered much less volatile than the market.

You can find a company's beta at Web sites that usually provide a lot of financial information, such as Nasdaq's Web site (`www.nasdaq.com`) or Yahoo! Finance (`finance.yahoo.com`).

The beta is useful to know because it gives you a general idea of the stock's trading range. If a stock is currently priced at $50 and it typically trades in the $48–$52 range, a trailing stop at $49 doesn't make sense. In this case, your stock will probably be sold the same day you initiate the stop-loss order. If your stock is a volatile growth stock that could swing up and down by 10 percent, set your stop-loss order more logically at 15 percent below that day's price.

The stock of a large-cap company in a mature industry tends to have a low beta — one close to the overall market. Small- and mid-cap stocks in new or emerging industries tend to have greater volatility in their day-to-day price fluctuations; hence, they tend to have a high beta. (You can find out more about large-, small-, and mid-cap stocks in Chapter 3.)

Limit orders

A limit order is a very precise condition-related order, implying a limit exists either on the buy or the sell side of the transaction. You want to buy (or sell) only at a specified price or better. Period. Limit orders work well for you if you're buying the stock, but they may not be good for you if you're selling the stock. Here's how it works in both instances:

- **When you're buying:** Just because you like a particular company and you want its stock, it doesn't mean you're willing to pay the current market price. Maybe you want to buy Kowalski, Inc., but the current market price of $20 per share isn't acceptable to you. You prefer to buy it at $16 because you think this price reflects its true market value. So what do you do? You tell your broker, "Buy Kowalski with a limit order at $16." You also have to specify whether it's a day order (good for the day) or a GTC order (which we discuss in its own section in this chapter).

  What happens if the stock experiences great volatility? What if it drops to $16.01 and then suddenly drops again to $15.95 on the next move? Actually, nothing happens, you may be dismayed to hear. Because your order was limited to $16, it can be transacted only at $16, no more or less. The only way for this particular trade to occur is if the stock rises back to $16. However, if the price keeps dropping, then your limit order isn't transacted and it may expire or be cancelled.

  On the other hand, many brokers, including TD Waterhouse, interpret the limit order as "Buy at this specific price or better." Presumably, if your limit order is to buy the stock at $10, you'll be just as happy if your broker buys that stock for you at $9.95. This way, if you don't get exactly $10 because the stock's price was volatile, you'll still get the stock at a lower price. Speak to your particular broker to be clear about their meaning of a limit order.

- **When you're selling:** Limit orders are activated only when a stock hits a specific price. If you buy Kowalski, Inc., at $20 and you worry about a decline in the share price, you may decide to put in a limit order at $18. If you watch the news and hear that Kowalski's price is dropping, you may sigh and say, "I sure am glad I put in that limit order at $18!" However, in a volatile market, the share price may leapfrog over your specified price. It could go from $18.01 to $17.99 and then continue its descent. Because the stock price never hit $18 on the mark, it isn't sold. You may be sitting at home satisfied (mistakenly) that you played it smart while your stock plummets to $15, or $10, or worse! This is why having a stop-loss order in place is best.

Pass the Margin, Please

Margin means buying securities, such as stocks, by using funds you borrow from your broker. Buying stock on margin is similar to buying a condominium with a mortgage. If you buy a condominium at the purchase price of $100,000 and put 10 percent down, your equity (the part you own) is $10,000 and you borrow the remaining $90,000 with a mortgage. If the value of the condo rises to $120,000 and you sell (for simplicity's sake, we don't include closing costs in this example), you will have obviously made a profit of $20,000. The $20,000 gain on the property represents a gain of 20 percent on the purchase price of $100,000, but because your real investment was $10,000 (the down payment), your gain effectively works out to 200 percent (a gain of $20,000 on your initial investment of $10,000).

Buying on margin is an example of using leverage to maximize your gain when prices rise. Leverage is simply using borrowed money to increase your profit. This type of leverage is great in a favourable (bull) market, but it works against you in an unfavourable (bear) market. Say a $100,000 condominium you purchase with a $90,000 mortgage falls in value to $80,000 (property values can decrease rapidly during economic hard times). Your outstanding debt of $90,000 exceeds the value of the property. Because you owe more than you own, you have a negative net worth. Leverage is a double-edged sword.

Examining marginal outcomes

Suppose you think the stock for the company Mergatroid, Inc., currently at $40 per share, will go up in value. You want to buy 100 shares, but you have only $2,000. What can you do? If you're intent on buying 100 shares (versus simply buying the 50 shares you have the cash for), you can borrow the additional $2,000 from your broker on margin. If you do that, what are the potential outcomes?

If the stock price goes up

This is the best outcome for you. If Mergatroid goes to $50 per share, your investment will be worth $5,000 and your outstanding margin loan will be $2,000. If you sell, the total proceeds will pay off the loan and leave you with $3,000. Because your initial investment was $2,000, your profit is a solid 50 percent, because ultimately your $2,000 principal amount generated a $1,000 profit. (For the sake of this example, we leave out any charges such as commissions and interest paid on the margin loan.) However, if you pay the entire $4,000 upfront — without the margin loan — your $4,000 investment will generate a profit of $1,000, or 25 percent. Using margin, you double the return on your money.

Leverage, when used properly, is very profitable. However, it is still debt, so understand you must pay it off eventually.

If the stock price fails to rise

If the stock goes nowhere, you still have to pay interest on that margin loan. If the stock pays dividends, this money can defray some of the cost of the margin loan. In other words, dividends can help you pay off what you borrow from the broker.

Having the stock neither rise nor fall may seem like a neutral situation, but you pay interest on your margin loan with each passing day. (Your interest expense is tax deductible, however.) For this reason, margin trading can be a good consideration for conservative investors only if the stock pays a high dividend. Many times, a high dividend from $4,000 worth of stock can exceed the margin interest you have to pay on the $2,000 you borrow from the broker to buy that stock.

If the stock price goes down

If the stock price falls, buying on margin can work against you. What if Mergatroid goes to $38 per share? The market value of 100 shares will be $3,800, but your equity will shrink to only $1,800 because you have to pay back your $2,000 margin loan. You're not exactly looking at a disaster at this point, but you'd better be careful, because the margin loan exceeds 50 percent of your stock investment. If it goes any lower, you may get the notorious *margin call,* when the broker actually contacts you to ask you to restore the ratio between the margin loan and the value of the securities. See the following section for information about appropriate debt-to-equity ratios.

Maintaining your balance

When you purchase stock on margin, you must maintain a balanced ratio of margin debt to equity of at least 50 percent. If the debt portion exceeds this limit, you'll be required to restore the ratio by depositing either more stock or more cash into your brokerage account. The additional stock you deposit can be stock transferred from another account.

If, for example, Mergatroid falls to $28 per share, the margin loan portion exceeds 50 percent of the equity value in that stock — in this case, the market value of your stock is $2,800, but the margin loan is still at $2,000. The margin loan is a worrisome 71 percent of the market value ($2,000 ÷ $2,800 = 71 percent). Expect to get a call from your broker to put more securities or cash into the account to restore the 50-percent balance.

If you can't come up with more stock, other securities, or cash, the next step is to sell stock from the account and then to use the proceeds to pay off the margin loan. For you, it means realizing a capital loss — you lost money on your investment.

Margin, as you can see, can escalate your profits (on the upside), but magnify your losses (on the downside). If your stock plummets drastically, you can end up with a margin loan that exceeds the market value of the stock you used the loan to purchase. In the bear market of 2000, many people were hurt by stock losses, and a large number of these losses were made worse because people didn't manage the responsibilities involved with margin trading.

If you buy stock on margin, use a disciplined approach. Be extra careful when using leverage, such as a margin loan, because it can backfire. Keep the following points in mind:

- **Have ample marginable securities in your account.** Try to keep the margin ratio at 40 percent or less to minimize the chance of a margin call.
- **Consider using margin to buy stock in large companies that have a relatively stable price and pay a good dividend (if you're a beginner).** Some people buy income stocks that have dividend yields that exceed the margin interest rate, meaning the stock ends up paying for its own margin loan. Just remember those stop orders.
- **Monitor your stocks constantly.** If the market turns against you, the result will be especially painful if you use margin.
- **Have a payback plan for your margin debt.** Margin loans against your investments mean you're paying interest. Your ultimate goal is to make money, and paying interest eats into your profits even if the interest expense is tax deductible.

Going Short and Coming Out Ahead

The vast majority of stock investors are familiar with buying stock, holding on to it for a while, and hoping its value goes up. This kind of thinking is called *going long,* and investors who go long are considered to be *long on stocks.* Going long essentially means you're bullish and seeking your profits from rising prices. However, astute investors also profit in the market when stock prices fall. *Going short* (also called *shorting a stock, selling short,* or *doing a short sale*) on a stock is a common technique for profiting from a stock price decline. Investors have made big profits during bear markets by going short. A short sale is a bet that a particular stock will go down.

To go short, you have to be deemed (by your broker) creditworthy — your account needs to be approved for short selling. When you're approved for margin trading, you're probably all set to sell short, too. Speak to your broker (or check for this information on the broker's Web site) about limitations in your account regarding going short.

Because going short on stocks carries greater risks than going long, we strongly advise beginning investors to avoid shorting stocks until they become more seasoned.

Most people easily understand making money by going long. It boils down to "Buy low and sell high." Piece of cake. Going short means making money by selling high and then buying low. Huh? Thinking in reverse is not a piece of cake. Although thinking of this stock adage in reverse may be challenging, the mechanics of going short are really very simple. Consider an example that uses a fictitious company called DOA, Inc. As a stock, DOA ($50 per share) is looking pretty sickly. It has lots of debt and plummeting sales and earnings, and the news is out that DOA's industry will face hard times for the foreseeable future. This situation describes a stock that is an ideal candidate for shorting. The future may be bleak for DOA, but promising for savvy investors.

You must understand brokerage rules before you conduct short selling. The broker must approve you for it, and you must meet the minimum collateral requirement, which is typically 150 percent of the shorted stock's market value. If the stock generates dividends, those are paid to the owner of the stock, not to the person who is borrowing it to go short. (See the next section, "Setting up a short sale," to see how this technique works.) Check with your broker for complete details.

Setting up a short sale

This section explains how to go short. Say you believe DOA is the right stock to short — you're pretty sure its price is going to fall. With DOA at $50, you instruct your broker to "Go short 100 shares on DOA." (It doesn't have to be 100 shares; we're just using that as an example.) Now, here's what happens next:

1. **Your broker borrows 100 shares of DOA stock, either from his own inventory or from another client or broker.**

   That's right. The stock can be borrowed from a client, no permission necessary. The broker guarantees the transaction, and the client/owner of the stock never has to be informed about it, because she never loses legal and beneficial right to the stock. You borrow 100 shares, and you'll return 100 shares when it's time to complete the transaction or when you're told to — which isn't very often.

2. **Your broker then sells the stock and gives you the money.**

   Your account is credited with $5,000 (100 shares × $50) in cash — the money gained from selling the borrowed stock. This cash acts like a loan on which you're going to have to pay interest.

3. **You use the $5,000 for a little while.**

   Your broker has deposited the $5,000 into your account. You can use this money to buy other investments.

4. **You buy the stock back and return it to its rightful owner.**

   When it's time to close, or cover, the transaction (either you want to close it or the owner of the shares wants to sell the shares, so you have to give them back), you must return the number of shares you borrowed (in this case, it was 100 shares). If you buy back the 100 shares at $40 per share (remember, you shorted this particular stock because you were sure its price was going to fall) and these 100 shares are returned to their owner, you make a $1,000 profit. (To keep the example tidy, we don't include brokerage commissions.) By selling short, you made money when the stock price fell!

Oops! Going short when prices grow taller

We bet you guessed there was a flip side to the wonderful profitability of selling short. Presume you were wrong about DOA and the stock price rises from the ashes as it goes from $50 to $87. Now what? You still have to return the 100 shares you borrowed. With the stock's price at $87, you have to buy the stock for $8,700 (100 shares at the new, higher price of $87). Ouch! How do you pay for it? Well, you have that original $5,000 in your account from when you initially went short on the stock. But where do you get the other $3,700 ($8,700 less the original $5,000)? You guessed it — your pocket! You have to cough up the difference. If the stock continues to rise, that's a lot of coughing.

How much money do you lose if the stock goes to $100 or more? A heck of a lot. As a matter of fact, theoretically no limit exists to how much you can lose. That's why going short can be riskier than going long. With going long, the most you can lose is 100 percent of your money. However, with going short, you can lose more than 100 percent of the money you invested. Yikes!

Because the potential for loss is unlimited when you short a stock, we suggest you use a stop order (also called a buy-stop order) to minimize the damage. Better yet, make it a good-till-cancelled order, which we discuss earlier in this chapter. You can set the stop order at a given price, and if the stock hits that price, you buy the stock back so you can return it to its owner before the price rises even higher. You still lose money, but you limit your losses.

Watching out for ticks no longer

Short sellers used to be aware of the uptick rule, which states that you can enter into a short sale only when the stock has just completed an uptick. Now, short sellers can only sell short at the same price as the last sale. The reason for this rule is that short selling can aggravate declining stock prices in a rapidly falling market. In practice, going short on a stock whose price is already declining can make the stock price fall even more so. Excessive short selling can make the stock more volatile than it would be otherwise. U.S. securities regulations don't have a similar uptick or last sale rule.

Feeling the squeeze

If you go short on a stock, remember that, sooner or later, you have to buy that stock back so you can return it to its owner. What happens when a lot of people are short on a particular stock and its price starts to rise? All those short sellers will be scrambling to buy the stock back so they can close their transactions before they lose too much money. This mass selling quickens the pace of the stock's ascent and puts a squeeze (called a short squeeze) on the investors who had been shorting the stock.

Earlier in the chapter, we explain that your broker can borrow stock from another client so you can go short on it. What happens when that client wants to sell the stock in her account — the stock that you borrowed and that is no longer in her account? When that happens, your broker asks you to return the borrowed stock. That's when you feel the squeeze — you have to buy the stock back at the current price unless you can borrow it from another client.

Going short can be a great manoeuvre in a declining (bear) market, but it can be brutal if the stock price goes up. If you're a beginner, stay away from short selling until you have enough experience (and money) to risk it.

Chapter 6

Investing in Bonds

In This Chapter

- Understanding bonds and identifying types of bonds
- Choosing strip bonds
- Matching maturity dates to strategy
- Knowing where and how to buy bonds

Next to mutual funds, bonds are among the most confusing investment choices for the majority of Canadians. That's because bonds have a mystique about them — with the exception of Canada Savings Bonds (CSBs), which many people use as a means of forced savings.

Bonds are not as complex as you may think, and by the time you reach your mid-30s, they deserve a place in your investment portfolio, in one form or another.

What Is a Bond?

Bonds are a simple idea made complicated by time. Essentially, a bond is an IOU issued by a corporation or a government in exchange for cold, hard cash. Here's an easy way to understand bonds.

If a friend asks to borrow a hundred dollars from you until the end of the month, she may offer an IOU promising to pay you back on that particular day. Bonds aren't much different, especially if your friend agrees to pay you interest on the loan.

But suppose your friend wants to borrow the money for a little longer than a month — say, 30 years? That changes things quite a bit.

First, you would hope she'll still be your friend in 30 years, and that she'll be around to pay back the loan. Also, instead of waiting 30 years for the entire amount to be repaid plus interest — which would be a pile of interest — you would probably appreciate receiving a series of interest payments from time to time. That's when the one big IOU becomes a series of little IOUs, promising to pay interest on the loan once or twice a year. Each small IOU would have a date on it, indicating when the payment was due. You would agree to give each small IOU back to your friend on its date in exchange for cash payment, representing interest earned on the loan.

If you needed cash before the term of the loan was up, you could obtain it by selling the IOU to someone else. If this third person knows nothing about your friend, and has doubts about her ability to repay the loan, it will influence the price he or she is willing to pay for the IOU. Familiarity and trust reduce the risk and raise the price; unfamiliarity and distrust increase the risk and lower the price. The time to maturity (the duration) also affects price. Short IOUs are nice; long IOUs can be nasty. All bonds work essentially the same way.

The date on which a bond/IOU must be paid is called its maturity date, and the difference between the price paid for the bond and its value at maturity, divided by the number of years between then and now, equals the annual interest (see Table 6-1).

Table 6-1 Interest Calculation on Bond's Issue Date

Price you pay for the bond:	$1,000
Value of the bond at maturity:	$2,000
Difference in value:	$1,000
Number of years to maturity:	10
Annual interest earned ($1,000 divided by 10):	10%

These days, with interest rates hovering near 30-year lows, 10 percent guaranteed interest is very appealing for a high-quality bond. In fact, if the *issuer* of the bond — whoever borrowed the money in the first place — is well known, with a good credit rating, people would pay more for this bond if you were selling it, lowering the actual annual interest rate. If you offered this bond for sale, you may be paid $1,400 for it, earning you an immediate $400 profit (see Table 6-2).

Table 6-2 Interest Calculation If Rates Drop	
Price you received for the bond:	$1,400
Value of the bond at maturity:	$2,000
Difference in value:	$600
Number of years to maturity:	10
Annual interest earned ($600 divided by 10):	6%

But if interest rates suddenly skyrocket, as they did in the early 1980s when you could earn 14 percent a year from money in your savings account, your 10 percent annual interest will be almost an insult. So you'll receive *less* for the bond than you paid in order to earn *more* in annual interest (see Table 6-3).

Table 6-3 Interest Calculation If Rates Rise	
Price you received for the bond:	$500
Value of the bond at maturity:	$2,000
Difference in value:	$1,500
Number of years to maturity:	10
Annual interest earned ($1,500 divided by 10):	15%

Notice three things here:

- Nothing about the bond has changed except its selling price. The company or government issuing the bond is the same; the maturity date is the same; the face value of the bond is the same. The only difference is the current interest rate available from other sources.
- You can make money from bonds in two ways. First, from the interest they earn for you, and second, from buying and selling bonds just as you would buy and sell any other item.
- Bond prices and interest rates are opposite riders on the same teeter-totter — when one goes up, the other drops. Veterans of bond trading like to point out that the bond market is a good place to invest because something goes up every day — some days it's bond prices, other days it's bond yields! So the bond you buy today for $1,000 may be worth substantially less next month if the interest rate climbs higher. If

the interest rate on bonds you hold is high enough, and the life of the bond is long enough, this shouldn't be a major concern to you. But it illustrates that a very real risk exists even with so-called "guaranteed" bonds. Don't be lulled into a sense of false assurance whenever you think of the word "bond." What with the recent and somewhat ongoing credit crisis, the Canadian and U.S. financial landscape is littered with good bonds gone bad! Today's blue-chip bonds can very easily become tomorrow's junk bonds — especially if they're connected to the sub-prime mortgage mess.

Understanding what a bond represents

When a government or corporation issues bonds — basically a batch of IOUs borrowing money to expand the business, pay debts, improve facilities, and for other practical reasons — it is faced with a number of decisions:

- How much money do we need to raise? (Always a prime concern)
- How long can we take to pay it back? (Usually from 5 to 30 years)
- How much annual interest will we have to pay? (Determined by current interest rates and the level of risk involved)

Government-guaranteed bonds are not always issued by governments. Back in the early 1980s, when interest rates soared through the stratosphere, you could purchase Ontario Hydro bonds, guaranteed by the Government of Ontario, that paid *14 percent annual interest for 25 years!* Because mortgages were earning close to 20 percent in annual interest and inflation (the cost of living) was a serious double-digit figure at the time, this wasn't quite as dramatic as it sounds. But interest rates go up and down over time, and clever (or well-advised) investors stocked up on Hydro bonds. When interest rates dropped, the other end of the teeter-totter took off. Investors sold the bonds at a fat profit and moved the money into equity-based mutual funds. None of this is rocket science among sophisticated investors, of course. But you don't have to be sophisticated to take advantage of these opportunities. You just have to read books like this one to understand the basic principles. So keep reading!

After bonds are issued by a company through an investment dealer, they are traded the same as any other commodity, from pork bellies to uncut diamonds. The price people will pay to obtain the bonds is based, as with commodities, on how much profit the buyer believes he can make and how much risk is involved.

For example, bonds issued or guaranteed by a government are low risk because most governments can always find a way to pay their debts — they

simply raise taxes. But because government-guaranteed bonds carry minimum risk, they don't have to pay high interest to attract your money.

Bonds issued by a corporation whose reputation is less than perfect, or whose coffers are not filled with gold bars, must pay higher interest to match the risk involved.

Looking at gilt-edged, blue-chip, and junk bonds

Bond rating services, such as Dominion Bond Rating Service (`www.dbrs.com`), are companies that employ experts who spend their career evaluating bonds and the firms or governments issuing them, assigning each a rating based on the risk involved. A bond whose likelihood of being paid at maturity is about as certain as the sun rising tomorrow morning is rated AAA. A niggling doubt may reduce it to A+ or A. Serious concerns will topple a bond down to a C or D rating.

- **AAA- and AA-rated bonds** are considered high-grade, with little risk of default. They include bonds guaranteed by federal and provincial governments as well as the bluest of blue-chip companies.
- **A- and BBB-rated bonds** represent moderate risk, and are usually issued by large corporations.
- **BB- and lower-rated bonds** carry a more serious risk of default, meaning you could lose your entire investment in them. Bonds in this category are marketed as high-yield bonds, more familiarly called *junk bonds*.

A bond's rating has a direct impact on the price the market will pay for the bond, and the amount of interest the bond must earn to attract investors. In that sense, bond rating services are like handicappers at a horse race, telling you which nag is likely to finish in the money. If you go along with their views, your odds of winning may be better, but the amount of money the cashier pays for your ticket will be lower.

Gilt-edged bonds are rated AAA or AA. These are issued by federal or provincial governments and large, well-managed companies with excellent reputations, usually referred to as *blue-chip* firms. In Canada, this includes corporations such as Manulife Financial and the chartered banks. It can also include corporations whose reputations may have been tarnished in recent years, such as the former Ontario Hydro, but whose payment of their bonds is guaranteed by the government.

The bonds that most Canadians are familiar with are Canada Savings Bonds (CSBs), which may seem like a wise addition to your RRSP. Except some CSBs weren't eligible for an RRSP unless they were called *Canada RRSP Bonds.* Then their name was changed to *Canada Premium Bonds.* Isn't government wonderful?

Whatever their current name, CSBs for RRSPs pay compound interest (the interest you earn this year earns its own interest next year), are 100 percent guaranteed by the Government of Canada, and can be purchased by anyone who has had a permanent residence in Canada for at least six months. The minimum purchase for RRSP-eligible bonds is $500, and they are available in denominations of $500, $1,000, $5,000, and $10,000.

Junk bonds — or *high-yield* bonds, as they are known in more polite circles — are at the other end of the risk scale from CSBs. These IOUs, which tend to have short maturity dates and pay very high interest rates, may be issued by companies as a means of financing the takeover of another firm. The odds of the company covering these bonds may still be in your favour, but the risk of losing your entire investment remains.

Between these two extremes are bonds issued by lesser corporations that may or may not be around with the money they owe you when the bonds reach maturity. These include smaller but solid companies such as Domtar and Enbridge, and it's worth obtaining professional advice before deciding to risk your funds in them.

The lower a bond's alphabetical rating, the higher the interest it pays. In early 2008, bonds rated BB, which is edging into junk-bond territory, averaged 6.85 percent, or about 3 percent more than top-rated bonds. Bonds three notches lower, at the CC level, were averaging 16.5 percent interest. Pretty tempting? Yes, but if the company issuing the bond defaults, you are left holding a very pretty piece of paper — and not much more than a capital loss, which might help lower your income taxes.

Junk bonds can pay *very* impressive interest rates. It may be appealing, when everyone else is promising a paltry 5 percent annual interest for their bonds, to invest a few bucks in a junk bond promising annual interest of 12 to 16 percent. If faced with this opportunity — probably not by a qualified professional financial adviser, by the way — take a long walk around the block before reaching your decision. If you still want to throw your money at some junk bonds, take another walk . . . and another. In the end, the decision is yours. But don't make it without a lot of thinking and a lot of walking.

Knowing Why Strip Bonds Are a Good Choice

A bond's small IOUs, which pay interest once or twice a year, are called *coupons* and used to come attached to the bond itself. The world was filled, or so we are told, with cackling millionaires whose days consisted of removing bonds from their vaults and clipping off the coupons, which they spent like cash. Try not to think about them right now. . . .

Bonds consist of coupons, which represent the scheduled interest to be paid over the life of the bond, and the *residual,* which is the original (or *par*) value of the bond. If you own a $100 (par value) Government of Canada bond paying 8 percent annual interest and maturing on January 1, 2020, it includes coupons dated December 1 and June 1 for each year between the date it was issued and its maturity date. Each coupon is worth $4.00, representing 4 percent of the par value; two coupons each year produce 8 percent annual interest.

But nobody says you must have all the coupons and the residual in one piece on the bond. Each can be removed and traded at whatever price buyers and sellers agree upon for them.

When coupons and the residual have been removed from a bond, the bond is undressed. It's actually called *stripped* — but bonds can be dull stuff for some people, so think of them as naked if it makes them more interesting. (Even *strip* sounds a bit risqué in some tonier circles, where you may hear them referred to as *zero-coupon bonds.*)

Actually, coupons are no longer physically stripped from a bond. Instead, they are *book-based,* which means they exist only as an entry in a centralized financial registry called the Central Depository System (CDS).

Both the coupons and the residual have a fixed value on their maturity date. Will you pay that price to purchase them before that date? Of course not. How can you make money by paying $100 today for something that will be worth $100 in 5, 10, or 20 years? You will pay *less* than the amount shown on the coupon or residual. The difference between the price you pay today and the price it will be worth on its maturity date, divided by the number of years between now and then, equals the annual interest earned. In other words, it works precisely like a regular bond, but without regular interest payments.

Strip bonds are popular choices for a bunch of reasons, and they belong in the RRSP of anybody over age 35. Here's why:

- Strip bonds pay higher interest than guaranteed investment certificates.
- You know exactly how much interest you will earn between now and the bond's maturity date.
- Strip bonds are more liquid (you can sell them when necessary) than GICs, which lock you in for periods from six months to five years. Try cashing in your GIC before it comes due and you'll pay a fat penalty.
- Government-guaranteed strip bonds are even more secure than a GIC. GICs are guaranteed by the Canada Deposit Insurance Corporation to a maximum of $100,000 per account. But federal and provincial governments guarantee their bonds for the full unlimited amount.
- Strip bonds represent extra value for RRSP holders, because they hold no appeal for investors who buy bonds as a source of regular income. Hold a strip bond outside your RRSP and you are required to declare the increase in value each year on your income tax return. This means you'll pay tax on the profit, even though you are years away from actually pocketing it! In a tax-deferred RRSP, this doesn't apply. The result: Strip bonds appeal to a smaller segment of the market, which lowers their price and raises the interest they pay.
- When you purchase strip bonds, you'll receive a disclosure document indicating limits on their liquidity, tax implications, custodial arrangements, and safekeeping issues. None of these is critical to RRSP owners who plan on keeping the bonds within their RRSP until maturity.
- Strip bonds can be tailored exactly to fit every investor's age. If you turn 71 years old 26 years from now and you want money to live on, then you can invest in a 26-year government strip bond. Magic.

Deciding between Short-Term and Long-Term

Short-term bonds, maturing in two years or less, provide you with flexibility. The interest they produce will be relatively low, but they'll be converted into cash fairly soon, opening up new opportunities.

Long bonds, shorthand for "long-term," are the same size as short models — "long" indicates a maturity date far into the future. They usually but not

always pay higher interest rates than short-term bonds, because long-bond buyers want protection against the danger of inflation between the day they buy the bond and the day it matures. The longer the term, the higher the risk of inflation.

Long bonds are almost as flexible as short-term bonds, because there will always be a market for quality bonds. The question is, at what price? A rise in interest rates will reduce the price you can get for your bonds if you decide to sell them.

How to Buy Bonds

Bonds are available from banks, trust companies, credit unions, caisses populaires, full-service investment dealers, and licensed financial advisers. Most of the discount brokerages listed in Chapter 4 (see Table 4-2) also allow you to buy and sell certain types of bonds. Strip bonds are a little more difficult to obtain, although your self-directed RRSP administrator can purchase them for you. TD Canada Trust sells strip bonds. So do independent and bank-owned investment brokers such as BMO Nesbitt Burns and Blackmont Capital Inc., and full-service financial planners including Money Concepts and Assante.

Although it's wise to hold good bonds to maturity within your RRSP, there may come a time when you want their cash value before that date. This means you will be selling your bond on the secondary market, which is like a used car lot for bonds. The price you receive for your bond will depend on a number of factors, all as variable as the wind. These include the following:

- **Current interest rates:** If they have risen since you purchased the bond, you will receive less than you might expect. If they have dropped, you'll make extra profit.
- **The bond's maturity date:** Short-term bonds tend to have lower interest and therefore higher prices.
- **Bond features:** Some bonds come with extra features (or, as they may say in a used-car lot, "optional extras"). These include callable bonds — the lender reserves the right to pay you back before the maturity date — and extendable bonds, which means you could wait a little longer than you thought.
- **The creditworthiness of the lender:** If a company's fortunes have fallen since the bond was issued, the bond's price will drop to reflect this.

Remember the "No Free Lunch" Rule

No matter who sells you a bond — stripped, well-dressed, or junk — they are not doing it because they like your curly hair and sweet smile. They're doing it to make a profit. This probably does not qualify as headline news, but it should concern you because the profit charged by the bank, trust company, or dealer selling you the bond (or buying it from you) is both hidden and negotiable.

Most brokers, if you ask about commissions on bonds, will claim they don't charge any. They may say something like "We agreed on a ten-year stripped bond at 4.87 percent and that's what you received, with no commissions charged." Trouble is, when the brokerage firm purchased it on your behalf, the bond didn't pay 4.87 percent; it paid perhaps 5.25 percent. The difference? The broker paid *less* to buy the bond so the lower purchase price would have produced *more* interest earned between now and the bond's maturity date. How much more? That depends. But pay attention: If you sell the bond before its maturity date, your broker will pay you less than full market price, producing a lower earned annual interest than you might expect. So you pay a commission buying the bond and a commission selling it. Or, to put it succinctly: You lose coming and going. Think of this as the same difference between wholesale and retail prices.

All in all, you could wind up losing 2 full percentage points from the interest earned on your bond, without even knowing about it. Instead of earning you 7 percent annually, the bond earns you little more than 5 percent annually.

Does this make your broker, financial adviser, or self-directed RRSP administrator crooked? No, it's just the way things are done in the bond market. Bonds for small investors are bought and sold according to the interest they earn, not according to the actual purchase price. Nevertheless, keep in mind that, like banks, brokerage houses will try to bleed your pocketbook for as much as they can get away with!

So losing as much as 2 percent in annual interest should certainly concern you — especially because you can do something about it. Here's what to do:

- Get details on the recommended bond from your investment adviser. Write down the name of the company or government that issued the bond, the date of issue, its value, the maturity date, and, if possible, what's known as the CUSIP (Committee on Uniform Securities Identification Procedures) number.

- Ask your financial adviser who purchases the bonds for you to provide information on her firm's bond-commission policy. Refuse to believe a policy does not exist. Every major investment dealer has guidelines on bond commissions. If your adviser stonewalls you, inform her you're prepared to ask other firms the same question, looking for the best deal. Make it a threat and follow through! (It's always a buyer's market for RRSP owners.) Hey, it's your savings, not theirs.
- Contact a discount brokerage such as TD Waterhouse. Ask for the price and point spread of the bond recommended by your adviser, providing all the data you have. The difference, if any, should be your adviser's commission rate.
- Demand your broker or adviser confirm the commissions being earned on the bond she wants you to purchase, and the amount by which it reduces your earned interest. A difference of 0.50 percent between the two yields is acceptable. You owe your adviser something for her service, after all. Just don't overpay. For example: The bond price paid by your adviser's firm yields 5.75 percent annual interest; at the price you pay for it, the bond earns 5.25 percent. That's reasonable. Anything greater than 0.50 percent is like having your pocket picked.

All these demands and action by you will not generate unbridled delight from your investment adviser. Tough. It's your money, your future, and you have every right to know what something is really costing you. Simply remind your adviser that she is supposed to be working for and with you — not against you.

If you're really in a mood for mischief, ask your adviser for her best price on a bond you want to buy. About an hour later phone her again and say your rich uncle has exactly the same bond and wants to sell it to your adviser's bond department. What price are they willing to offer for the same bond you're considering buying? This will reveal two prices for the same bond: a selling price, which is what you were offered, and a buying price, which is usually about 2 percent lower than the selling price and which is what your "rich uncle" would have received.

Chapter 7

Screening Mutual Funds Online

In This Chapter

- Using online screening tools to find mutual fund values
- Investigating top screen sites
- Using (or not using) an online broker
- Knowing when to sell

This chapter gives you all the basic online tools for identifying mutual fund candidates, describing five types of online screening tools that can help you choose the mutual fund that best meets your needs. These mutual fund screens vary from simple to more advanced; the best online mutual fund screen is the one that includes the criteria most important to you.

What Am I Screening?

Before you can screen mutual funds, you have to know where to find the large online mutual fund databases:

- **globefund.com,** shown in Figure 7-1, has a large database of mutual fund profiles, which are essentially fact sheets. globefund.com also has an online portfolio tracking tool to help you place a current value on your mutual fund holdings. With this feature, you don't have to wait until the end of the month to find out what your holdings are worth. An available filtering tool lets you specify what type of fund you wish to find, how large the fund is, what the fees are, and other selection criteria. (More on the actual screening process is discussed later in this chapter.)
- **The Fund Library (`www.fundlibrary.com`)** lets you access detailed profiles on a wide array of Canadian mutual funds. At this site, you can

also set up a portfolio or watch list of mutual funds you wish to track, and personalize the way you want to view this information. The Fund Library also has discussion forums to let you chat online with other mutual fund investors, and lets you access vast educational resources in their online learning centre. Its fund rating tool will help you make the right mutual fund choices.

- **Morningstar Canada (`www.morningstar.ca`)** has a comprehensive listing of just about any Canadian mutual fund available. The information is free, but you are asked to register by providing a bit of general information about yourself. When you have access, you can track your holdings with Morningstar's portfolio manager tool to help you analyze the mix and value of your holdings. The sister Web site at `www.morningstar.com` lets you do the same type of analyses as the Canadian site, but also gives you information on about 14,000 U.S.–based mutual funds. You can also find out more about investing in mutual funds sold outside North America.

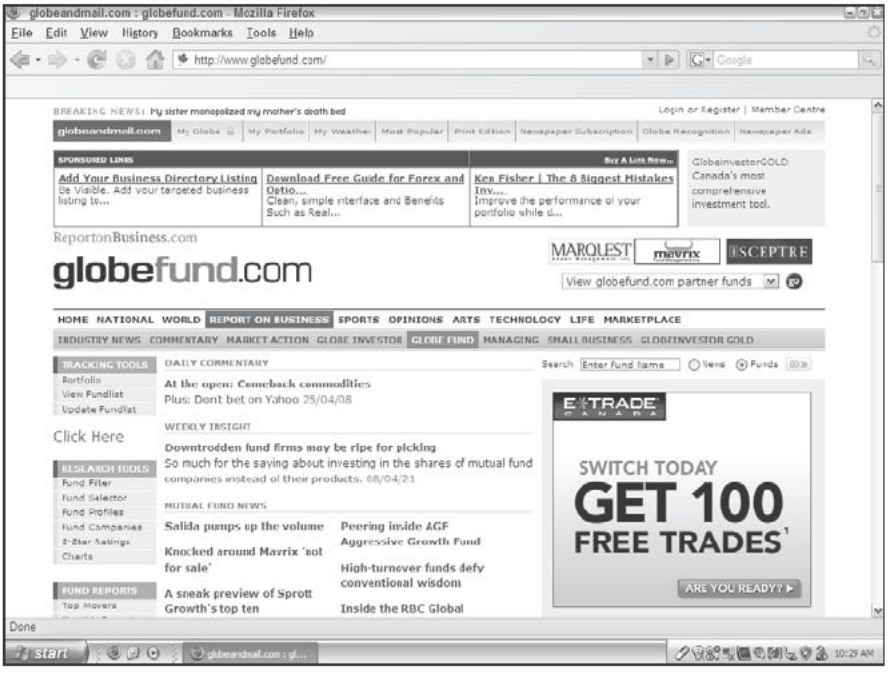


Figure 7-1: globefund.com has comprehensive information about mutual funds offered in Canada.

How to Screen Mutual Funds Online

The Internet provides a variety of mutual fund screening tools that sort thousands of U.S. and Canadian mutual funds by criteria you select. For example, you may want one type of fund for your children's education — something long-term because you don't need the money for 10 to 20 years — and a different fund for your retirement to help you get a steady stream of income and to reduce your current tax liabilities. With online screening tools, you can evaluate several funds that meet your financial needs.

Most investment screening Web sites are free. But an exception always exists. Morningstar Canada's (`www.morningstar.ca`) BellCharts feature is just about the most powerful mutual fund screening tool available for Canadian funds. But it will cost you a fee. Subscription rates are accessible on the Morningstar Canada Web site.

Screening a list of mutual funds residing in a database is an inexpensive way to isolate mutual funds that meet your special criteria. Be wary that some databases list funds incorrectly or have outdated information; however, they are useful for pruning a long list of candidates to a manageable short list.

Some mutual fund screening programs, like MSN Investor (`moneycentral.msn.com/investor`), are for beginners. Others, such as BellCharts (offered through Morningstar Canada), require a bit of practice. Some mutual fund screens, such as BellCharts, allow you to download the data to your Excel spreadsheet program so you can do in-depth additional analyses offline.

Each screening site uses different criteria to sort mutual funds. You have to decide which criteria you care about and then use the site that offers the criteria you want. Any way you look at it, the selection of the right mutual fund is still up to you.

Here's an overview of the features of a few mutual fund screens that are best for beginning online investors:

- **Morningstar Canada (`www.morningstar.ca`)** has a screening tool called Fund Selector (see Figure 7-2), which lets you screen and create a short list of Canadian mutual funds by fund sponsor, fund category, load type, RRSP eligibility, fund assets, management expense ratio, Morningstar rating, and rate of return. At Morningstar Canada's home page, click the Fund Selector icon.

- **Morningstar U.S. (`www.morningstar.com`)** offers a free, independent service that evaluates mostly U.S. mutual funds. Its screening tools are even more selective than those found at Morningstar Canada.
- **Microsoft MoneyCentral Investor (`moneycentral.msn.com/investor`)** is free and has lots of features. You can select from a predefined fund search or perform a custom search using criteria you define (see Figure 7-3). The MoneyCentral Fund Finder lets you search a database of over 8,000 funds. The custom search criteria include the fund family name, investment focus, the fund's historical performance, overall rating, the minimum initial investment, risk ranking, and load status.

For more experienced investors, we recommend SmartMoney (`www.smartmoney.com`), which lets you reveal desirable investment opportunities by helping you research over 14,000 U.S. mutual funds and screen from over 60 criteria. You can view your results in different ways, save your favourite screens for repeated use, and further analyze funds using SmartMoney's fund snapshots and advanced charting and technical analysis tools. You can also use one of its predefined SmartMoney Fund Screens, and create a spreadsheet and download a detailed report on all your funds. The site charges a fee for this extensive service.

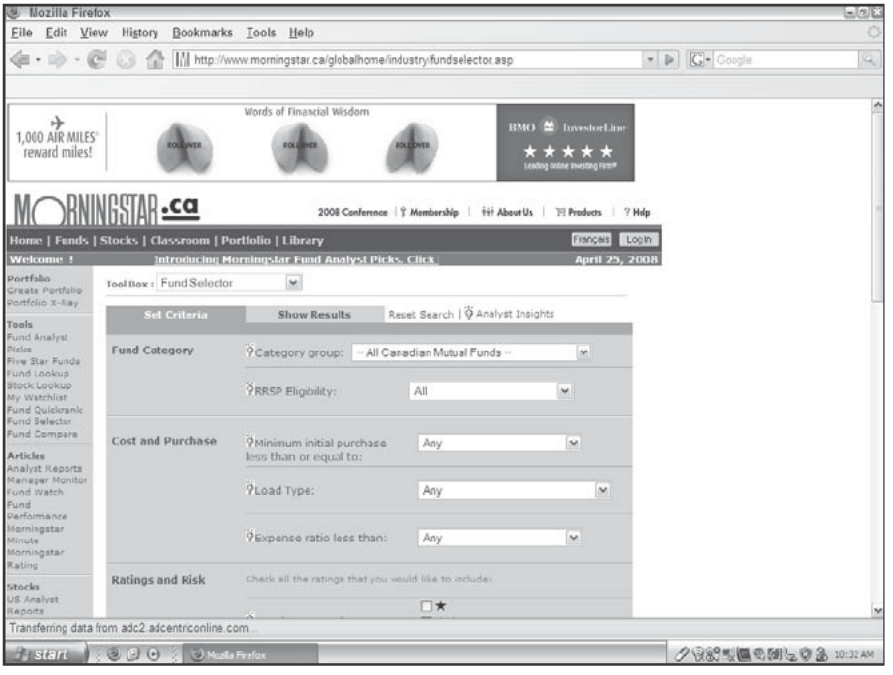


Figure 7-2: Morningstar Canada has a Canadian mutual fund performance screen called Fund Selector.

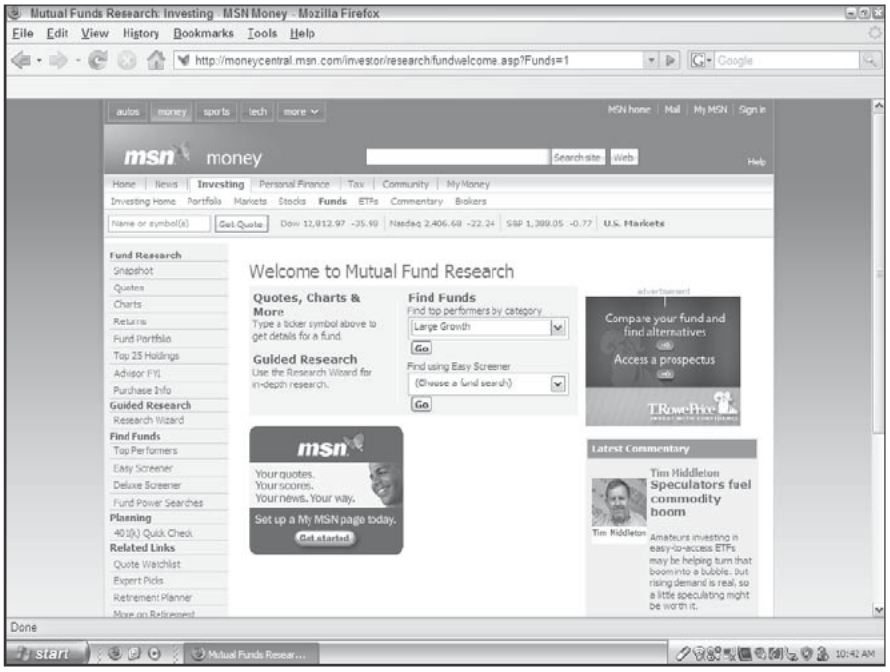


Figure 7-3: Thomson Investors Network screens Canadian and U.S. funds.

Buying Mutual Funds Online: No Broker Needed

When you have decided which mutual fund best suits your portfolio, you can purchase it without a broker. All you have to do is contact the company directly. Table 7-1 lists a few online mutual fund companies. The table shows the name of the mutual fund company and its Internet address.

Table 7-1 Examples of Online Mutual Fund Sources

Company	*Web Site Address*
AGF	www.agf.com
Altamira	www.altamira.com
Fidelity Funds	www.fidelity.com
Greenline Mutual Funds	www.tdcanadatrust.com
Mackenzie Funds	www.mackenziefinancial.com
Renaissance Investments	www.renaissanceinvestments.ca

Buying Mutual Funds Online: Using an Online Broker

You can purchase mutual funds through registered representatives of banks, trust companies, investment advisers, discount brokers, and financial planners. To purchase mutual funds via the Internet, go to a dealer's Web site.

Register by completing the online application form. You have to provide information about your income, net worth, social insurance number, and the type of account you desire. Sometimes you can open an account based on the quality (creditworthiness) of your information. However, to have a fully functioning account, dealers are required to have your signature on file. After they have your signature on file, you can buy or sell as much as you want.

After you open your account, you can log on to the Internet, go to your brokerage Web site, and enter orders by completing the online form. You can access your account at any time, check all your investments, and monitor your investments by using online news or quote services.

You have the following options for selecting a broker, virtually all having an online array of services:

- **A deep-discount broker:** The least-expensive type of broker ($7 to $15 per trade); no recommendations; contacting a human if an error occurs is often difficult.
- **A discount broker:** Less expensive than full-service brokerages; no recommendations; minimal human contact.
- **A full-service investment adviser:** Full commissions, recommendations, advice, and personal service.

Two examples of online brokers are:

- **E*TRADE Canada (`www.etrade.ca`),** which charges no fee as long as funds are held for at least 90 days (otherwise, a 1 percent or $39 minimum fee applies). However, the fund companies may charge fees themselves. This broker lets you trade more than 3,500 mutual funds.
- **HSBC InvestDirect** (formerly Merrill Lynch HSBC Canada) **(`investdirect.hsbc.ca`),** which offers no-fee (over 1,200 funds) and for-fee trades for thousands of mutual funds. The company also trades stocks, bonds, and options.

Selling Mutual Funds Online

If your fund becomes one of the worst performers, consider selling. You need to look at more than just the fund's rating, though. A few guidelines for determining when to sell a fund include:

- Look at the performance of comparable mutual funds. If a similar fund's overall performance is down 10 percent but your fund is down 16 percent and its performance consistently trails its peers, it may be a loser.
- If your fund has drifted from its original investment objectives, then it's not meeting your asset allocation goals. You'll lose all the benefits of diversification if you have two mutual funds investing in the same asset class.
- Keep track of changes in your fund's management. If the fund hires a new money manager, that person may have a different investment strategy.
- You may want to sell if your mutual fund's management expense ratio (MER) has crept up, or if you inherited the fund. High MERs reduce your returns and make the fund less profitable than similar funds with lower expenses.
- In a volatile market, you may discover you are a more conservative investor than you imagined. If you can't sleep at night, sell your fund.
- You are going to pay taxes on your capital gains. If one of your mutual funds is posting negative returns, you may want to consider selling it to offset your tax liabilities.
- If the fund increases by three or four times its original size in a short time period and its performance starts to decline, you may want to sell. As the fund keeps growing and growing, the professional money manager can't invest in the securities he or she knows and loves best, so the fund may start to acquire poor- or average-performing assets.
- Consider your needs. If you purchased the fund for a specific purpose and your life circumstances change, sell the fund and purchase one that meets your needs — even if the fund is doing well.

Funds that underperform in the short term can still be sound investments. For example, some Canadian funds did not outperform the Toronto Stock Exchange (TSX) in the past three years, but their average total returns over the past three years exceeded 20 percent.

Chapter 8

Internet Stock Screening

In This Chapter

- Becoming familiar with online stock screens
- Building your first stock screen
- Locating online and PC-based stock screens
- Using prebuilt stock screens

Stock screening boils down to finding the answer to one fundamental question: "Which stock (of all stocks) should I buy right now?" Of course, finding the answer to this question requires asking many more specific questions about stocks — difficult questions to answer without the help of computerized databases.

This chapter shows how you can use the Internet and PC-based stock screening tools to whittle down the universe of stocks to a manageable few candidates. You can then analyze your short list of stocks for a few gems that may bring you above-average returns. This chapter also tells you where to find daily or weekly results of prebuilt stock screens.

Finding the Best Stock Electronically

Screening is a process that permits investors to locate and distill information within a larger set of information. The Internet provides many screening tools to help you prospect stock issues. The goal of stock screens is to point out which stocks are worth your research and analysis time.

Some people believe that using a stock screen is like panning for gold. You use your computer to screen ("pan") for investment "nuggets" from a long list of possibilities. The individual investor sets the objectives of any single screen. Different people get different results because no two people have exactly the same selection criteria or investment philosophy.

Overall, the benefit of stock screens is that they let you generate your own ideas — ideas that should generate profits based on your investor savvy if successful. They also serve to quickly set you on the right track. From there,

you still have to use your own creativity and apply stock investing fundamentals. Stock screening programs might allow you to go beyond finding good stock investments and assist you in finding the very best stocks.

To identify investment candidates, the stock screen uses your predetermined criteria, such as *growth* (stocks expanding faster than the market or their peers); *value* (stocks having strong financial statements but selling at prices below their peers); or *income* (stocks providing higher than average dividends).

Depending on the criteria you select, you may have to run several iterations of the stock screen. For example, your first screen may result in several hundred possibilities. Because you can't investigate and analyze so many candidates, you have to run a second screen of these results. This fine-tuning should lead to a manageable list of investment candidates you can research and analyze — perhaps between 10 and 20. You can quickly pare down this number by using common sense and your investment experience.

Choosing the criteria for your first stock screen

Typically, you build a stock screen by accessing an online stock screening tool and filling out an online form. You can find examples of the variables used in these forms in this chapter, in the section "Important ratios for screening stocks." The first stock screen you develop may include the quantifiable variables you believe are the most important — for example:

- **Earnings growth:** The percentage of change between current earnings and earnings for the last quarter or last year.
- **Recent earnings surprises:** The difference between predicted and actual earnings.
- **Price-to-earnings (P/E) ratio:** The current price of the stock divided by the earnings per share. Value stocks have P/E ratios below 10 or 12, and growth stocks have P/Es above 20. Technology stocks can have P/E ratios above 30 and still be considered good value if their current and expected growth rates are high.
- **Dividends:** The annual cash dividend per share paid by the company.
- **Market capitalization:** The number of outstanding shares multiplied by the current stock price of those shares. Market capitalization is sometimes abbreviated to "cap" or referred to as "market cap." This value is a fundamental measurement of the company's size. Firms with high market capitalization are called "large cap" and companies with low market capitalization are called "small cap."

Fine-tuning your stock screen

After you select your initial screening criteria, you click Submit, Sort, or a similar command. A list of stock candidates appears. Often this list includes several hundred stocks. This number is still too large to research, so narrow the list by selecting more variables.

You may have some special knowledge about the industry you work in. You may have used certain products over the years and can use your knowledge to your advantage. However, keep in mind a good product doesn't necessarily mean a good company. You may want to filter out companies you just don't understand. You may also want to filter out companies about which you lack information. Without at least some basic information, you can't perform a complete analysis.

Using your stock screen results

After you complete your second stock screen and sort the data, you should have a list of about 10 to 20 companies. Start a file for each firm and begin to gather data for your analysis. At this point, you may discover through company-related news or press releases that some companies aren't worth additional research — a finding that further reduces your short list. For example, the company may have filed for bankruptcy, or it may be targeted for federal investigation. Maybe the company recently paid a large fine for shady dealings, or the executive management was recently indicted for fraud, misconduct, or some other crime.

Important ratios for screening stocks

Every industry has its own language, and the financial industry is no exception. The following sections offer definitions of the key terms the finance industry uses for stock-screening variables. Get to know them as you build and fine-tune your own stock screens.

Beta

Beta is an important measure of market risk. The beta is the relationship between investment returns and market returns. If the beta is negative, the company is inversely correlated to the market — that is, if the market goes up, the company's stock tends to go down. If a stock's volatility is equal to the market, the beta is 1. In this case, if the stock market increases 10 percent, the stock price increases 10 percent. Betas greater than 1.0 indicate the

company is more volatile than the market. For example, if the stock is 50 percent more volatile than the market, the beta is 1.5. Beta is simply a stock benchmark for volatility.

Book value

Book value is the original cost, less depreciation of the company's assets, less the outstanding liabilities. (Depreciation or amortization is the means by which an asset's value is expensed — or spread — over its useful life for accounting and tax purposes.) Book value is an accounting, not a market value, concept.

Cash flow to share price

The ratio of cash flow to share price is the company's net income plus depreciation or amortization (expenses not paid in cash) divided by the number of shares outstanding. For companies that are building their infrastructure (such as cable companies or new cellular companies) and, therefore, don't yet have earnings, this ratio may be a better measure of their value than earnings per share (EPS).

Current ratio

Current ratio is current assets divided by current liabilities. A current ratio of 1.00 or greater means the company can swiftly pay all current obligations without using future earnings. The quick ratio is current assets minus inventory, divided by current liabilities. It measures the readiness of a company to meet its current obligations in a matter of days.

Debt-to-equity ratio

To determine the debt-to-equity ratio, divide the company's total amount of long-term debt by the total amount of equity. (Equity is defined as the residual claim by shareholders of company assets after creditors and preferred shareholders have been paid.) This ratio measures the percentage of debt the company is carrying. Many firms average a debt level of 50 percent. Debt-to-equity ratios greater than 50 percent may indicate trouble. That is, if sales decline, the firm may not be able to pay the interest payments due on its debt.

Dividends

Dividends are paid quarterly out of retained earnings. However, many high-growth companies reinvest earnings and don't pay dividends.

Dividend yield

Dividend yield is the amount of the dividend divided by the current stock price. You can use dividends as a valuation indicator by comparing them to

the company's own historical dividend yield. If a stock is selling at a historically low yield, it may be overvalued. Companies that don't pay a dividend — many Canadian technology and resource stocks don't declare dividends — have a dividend yield of zero.

Earnings per share (EPS)

Earnings per share is probably the stock's most important feature. After all, the price you pay for a stock is based on the future earnings of the company. The consistency and growth of a company's past earnings indicate the likelihood of stock price appreciation and future dividends. Earnings per share is abbreviated as EPS.

Market capitalization

Market capitalization is a total value as calculated by multiplying the number of outstanding shares times the current price of those shares. Market capitalization is sometimes called market value.

P/E ratio

You calculate the price-to-earnings ratio by dividing the price of the stock by the current earnings per share. A low P/E ratio indicates the company may be undervalued. A high P/E ratio indicates the company may be overvalued. This measure depends on what industry you are evaluating.

Price-to-book value

Price-to-book value is the current price of the stock divided by the book value. If the current stock price is below the price-to-book value, the stock may be a real bargain. On the other hand, impending unprofitability or unjustified levels of intangible assets (such as goodwill) may be the reason.

Return on equity (ROE)

Return on equity (ROE) is usually equity earnings as a proportion of net worth. You divide the most recent year's net income by shareholders' equity (shareholders' equity is assets minus liabilities) to calculate the ROE.

Shares outstanding

The term *shares outstanding* refers to the total number of shares for a company. To determine the firm's outstanding shares, you need the most recent data. The shares outstanding can be calculated by taking issued shares on the balance sheet and subtracting treasury stock. Treasury stock is stock issued but not outstanding by virtue of being held (after it is repurchased) by the firm.

Using Online Stock Screens

Web-based stock screens can require between 2 and 30 variables. Their computerized stock databases can include anywhere from 1,100 stocks to more than 9,000 stocks. As well, some computerized stock databases are updated daily, weekly, or monthly. The best stock screen is the one that includes your personal investment criteria. A few examples follow:

- **Yahoo! Finance (**finance.yahoo.com**)** has one of the most comprehensive and powerful stock screens available on the Internet. After you click on the Screener feature, you can choose from an array of criteria to help you find an appropriate stock. Examples of criteria include share price, industry sector, multi-year performance, beta, sales, and several key ratios. This Web site feature can screen both Canadian and U.S. stocks, is absolutely free, and requires no pesky registration.
- **Adviceforinvestors.com (**www.adviceforinvestors.com**)** is a very good investment site that has stock screens geared to Canadian companies. A monthly subscription fee of about $10 applies to the basic subscription option. You have up to 20 screening criteria to select from including share price, exchange, industry, revenue, assets, price–earnings, and performance. This site also lets you access technical indicators to see where the stock price may be headed in the future. Click Stock Screening from the home page to access this tool.
- **GLOBEinvestor.com (**www.globeinvestor.com**)** has Canadian and U.S. stock screens. Criteria include North American stock exchange, industry sector, share price, and performance. The service is free and lets you view current and most recent quarter information about companies that met your criteria and were listed for you. From the list, you can click on handy icons to access a given company's financial statements, profile, and more.
- **Microsoft MoneyCentral Investor (**moneycentral.msn.com/investor**)** is free and has lots of features. You can select from more than 500 criteria to quickly create a list of companies that meet your standards, or, if you'd rather, you can use a pre-existing search and modify it to suit your needs. If you find a company in the results list that looks interesting, it's easy to export the symbol to your portfolio so you can keep an eye on it. When you have crafted just the right search, you can save it and run it again later. You can vary the number of matches you'll see in the results list from 1 to 100, or change the sort order by just clicking a column heading. You can also use Investment Matcher, a way to find companies with a similar market cap, average daily volume, price-to-sales ratio, and other specific criteria. Click the Stock Screener icon near the bottom of the home page to use it.
- **Nasdaq (**www.nasdaq.com**)** has its own stock screening tool, but it's limited to companies listed on Nasdaq-AMEX and the NYSE. It uses most of the variables mentioned in this chapter, and the database is updated daily. The screening tool is free.

Using Stock-Screening Software

PC-based stock screens use their own stock-screening software and databases. The advantage of these programs over Web-based stock screens is that they use hundreds of variables to screen stocks. PC-based screens are also a lot faster!

Equis International's MetaStock (www.equis.com) is an example of a technical analysis software product that includes a stock search engine, real-time charting, and an analysis tool. The program is compatible with Microsoft Office, which means you can download data to an Excel spreadsheet or embed charts in Word. You set the rules to identify trends and highlight important ratios. Click on a Canadian or U.S. stock price, and the program links your Internet browser to a free Web site that provides the current stock prices. When you purchase the software, you receive a CD-ROM with a historical database of more than 2,400 different U.S. securities, Canadian stocks, mutual funds, futures, and indexes. The price of MetaStock is US$499, and it can also be purchased under monthly or annual subscription rates.

The makers of MetaStock 10 use their software program to make stock recommendations. For example, they show the top five stocks that had the biggest gains over the past week, measured on a percentage basis. For example, a $20 stock that increases in price to $25 has a 25-percent gain.

Using Those Terrific Prebuilt Stock Screens

The Internet provides many prebuilt stock screens that use preselected criteria. Some of these screens may make your work easier because they already include the investment criteria you feel are most important. Here are a couple of the best:

- **The Motley Fool (**www.fool.com**)** offers a weekly discussion of its free stock screens of U.S. companies. Stocks are listed alphabetically as well as by descending percentages.
- **Zacks (**www.zacks.com**)** is one of the very few Web sites on the Internet that has a screening tool for Canadian stocks. It allows you to screen stocks on the Toronto Stock Exchange, where most Canadian public companies are listed. Their top-rated stocks have almost always outperformed the S&P 500 Index over the last ten years.

Chapter 9

Valuing Bonds Online

In This Chapter

- Making sense of Treasury securities
- Determining the value of any type of bond
- Discovering sources of news, statistics, and advice
- Where to buy and sell bonds

This chapter shows you how to analyze a variety of fixed-income investments, exploring the benefits of savings bonds, explaining new regulations, and discussing the limitations of this type of investment. For online investors who wish to know how to pay the right price for a bond, or when to bail out of one, this chapter shows how to value all types of bonds and determine bond yields (returns). Doing so may sound complicated, but with a little practice you'll be calculating your returns in no time. This chapter also provides a hot strategy that can protect you from interest-rate risk.

Treasury Securities and You

The federal government sells Canadian Treasury securities to the public in order to pay off maturing debt and raise the cash needed to operate the Canadian government. The Bank of Canada auctions them every other week. Three general types of treasury securities exist in both Canada and the United States. A U.S. Treasury bill, which is a popular form of treasury security, has a minimum purchase requirement of US$10,000. Canadian Treasury bills require minimums from $5,000 (for terms of 3 to 12 months) up to $25,000 (for 30- to 60-day terms). A U.S.–denominated Canadian Treasury bill (guaranteed by the Canadian government) has a minimum requirement of US$100,000. The chief difference between the U.S. and Canadian treasury securities, as seen in the following list, is the life of the obligation.

- **Treasury bills (T-bills)** mature in three months, six months, or one year. Treasury bills are purchased at a discount, so interest is actually paid. For example, you'll write a cheque for $10,000 and the government refunds the discount (which equals the interest rate determined at auction). In other words, your return is the difference between the purchase price and the maturity value.
- **Treasury notes (Canada notes)** are considered intermediate-term securities and mature in 2 to 10 years. Canada notes are denominated in U.S. dollars and provide interest payments to note holders.
- **Treasury bonds (Canada bonds)** are long-term securities that have maturities ranging from 10 years to 30 years. They are sold by auction to securities dealers and banks.

Government information is often written in a way that makes purchasing treasuries seem more difficult and complex than it really is. But don't get discouraged. For more information about understanding and purchasing Canadian and U.S. treasury securities, refer to the following online resources:

- **Bank of Canada (**`www.bankofcanada.ca`**):** This comprehensive site provides auction dates and news about Canadian treasury securities. It also has information about bonds, currency, inflation, financial markets, rates, and statistics. The Bank of Canada publishes its rationale behind interest rate and monetary policy, which is critical information investors can react to and capitalize on.
- **BondCan (**`www.bondcan.com`**):** This site provides detailed overviews about the bond market from a Canadian perspective. You can access a glossary of bond jargon, as well as a Bonds 101 feature that will help you better understand fixed income securities and markets. In addition to its periodic commentary and outlook features, it provides links to other Web resources dealing with Canadian and foreign bonds.
- **CIBC Economics Online (**`http://research.cibcwm.com/res/Eco/EcoResearch.html`**):** CIBC's online economics site, shown in Figure 9-1, lets you access research and overviews about Canadian government bonds, interest rates, and the provincial, national, and global economies. It publishes key economic indicators, forecasts, and statistics. You can access free and valuable industry analyses and economic commentary from the experts. The Week Ahead feature is especially valuable because it tells you what important economic news to expect in the coming month, and this information can help you hone your investing strategy.
- **ICAP GovPX (**`www.icap.com`**):** This site provides 24-hour, real-time quotations of U.S. government securities. The leading site also provides active lists of treasury bonds, notes, and bills with each financial instrument's coupon rate and maturity date. Lists include buyers' bid prices, sellers' asking prices, changes from the prior trading day, and yields. It also has useful links to related sites.

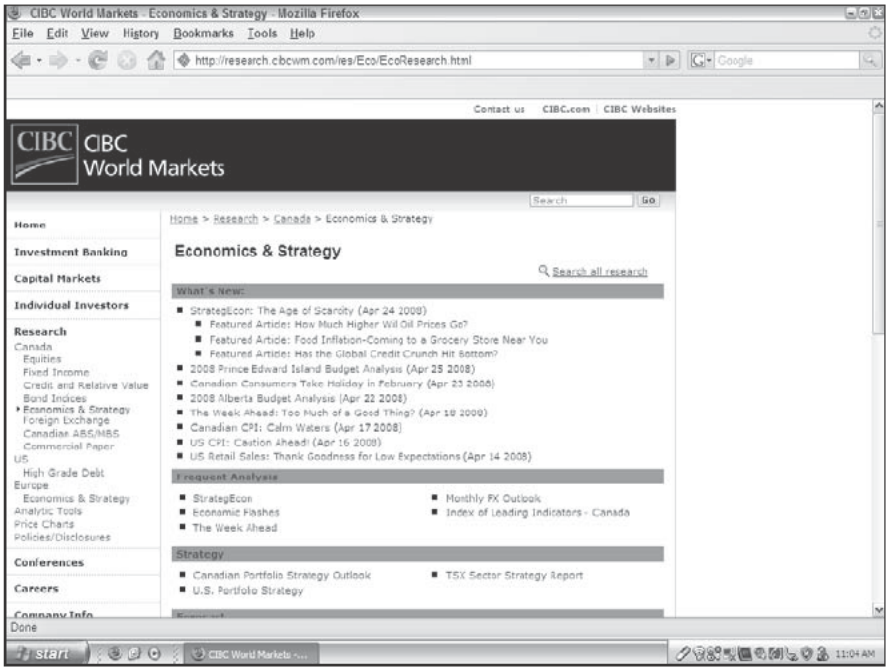


Figure 9-1: CIBC's market overviews help you determine where the Canadian and global economies are likely to go.

- **Zero-coupon bonds and strips (`http://www.newyorkfed.org/aboutthefed/fedpoint/fed42.html`):** Here you can get an explanation of these more sophisticated treasury securities from the Federal Reserve Bank of New York. While you're there, check out how the Fed works, scan the statistics, and access some important economic research and data. It's all free!

The Math of Bonds

The bond market is dominated by institutional investors (insurance companies, pension funds, mutual funds, and so on) that account for 80 to 85 percent of all trading. However, the impact of individual investors can also be felt through the purchases of mutual funds that specialize in bonds.

The following section shows the valuation process of bonds and the relationship of interest-rate changes to the value of bonds, providing several easy-to-use approaches that take the mystery out of determining your bond yield.

Calculating bond values

One such approach to determining your bond yield is by calculating the value of a bond.

A bond issued by a corporation is called a *debt instrument.* The bond states how the debtholder (investor) is repaid. Generally, these terms are normal debt arrangements. The borrower makes interest payments and then pays the principal at a predetermined date. Several things make bonds complicated, such as provisions to convert the bonds to common stocks at a predetermined stock value or terms that allow the bond issuer to retire the bond before maturity.

The value of a bond is based on the investor's overall assessment of the bond's worth at a given point in time. The receipt of future interest payments, the repayment of principal, and the credit rating or riskiness of the bond usually drive these assessments. You aren't obligated to hold a bond until maturity, and bonds are traded freely in the marketplace.

Calculating the value of a bond involves determining the present value of the interest payments and the eventual recovery of the principal. *Present value* means discounting the future cash flow to calculate how much you're willing to pay today for those future receipts.

At times, calculating the yield on bonds can seem more complicated than it really is. For example, if you purchase a one-year Treasury bill for $9,500 and redeem it in 12 months at full face value ($10,000), your gain is $500 (subject to Canadian income tax). To determine your yield, use the following formula (assuming your holding period is one year):

Face value – Price ÷ Price = Annual return

$10,000 – $9,500 ÷ $9,500 = 0.526 or 5.26%

See the section "The easy way to value your bond returns" in this chapter, where you can calculate the yield for a bond that has a maturity term greater than one year. Yield is a key performance indicator for bonds.

Creating yield curves

A yield curve is a diagram that illustrates the relationship of bond yields to maturities on a specific day. Yield curves can be used to decide which type of bond is best for your financial objectives. Bond yields and maturities are posted daily at *The Globe and Mail*'s Web site (`www.globeandmail.com`) and

at the *Wall Street Journal* Interactive Web site (`www.wsj.com`). Go to their respective business sections to find the link.

On a piece of graph paper on the horizontal axis, plot the maturities of treasury securities from left to right starting with the shortest maturity of 30 days to the longest maturity of 30 years. Then on the vertical axis, plot the yield of each treasury security. Next, connect the dots to make a yield curve. See the curve descriptions in the following list to find out what your results indicate:

- If the short-term rates are higher than the long-term rates, then the yield curve becomes *inverted,* or has a downward swing to it, which tells you this situation tends to be *bearish* for the market. In times like these, monetary policy is likely to be tight; the Bank of Canada or Federal Reserve will push up short-term rates.
- If the short-term rates are lower than the long-term rates, then the yield curve is *positive,* or has an upward swing to it, which usually indicates investors are willing to tie up their money in long-term commitments to reap higher rewards.
- If the short-term rates and the long-term rates are the same (or nearly the same), then the yield curve appears to be flat.

The yield curve approach also works for other types of bonds, such as government agency, municipal, or corporate bonds. Remember that you need to include in the curve only bonds with the same level of risk, such as all AA-rated corporate bonds.

The easy way to value your bond returns

Bonds are often quoted at prices that differ from their stated (or *par*) values, a situation that can be troublesome for investors who want to determine the yield of the bond. Still, many ways exist to calculate the yield value of a bond. The *approximate yield to maturity (YTM)* method provides the easiest way to determine a bond's current yield.

To calculate the approximate yield to maturity, you need the following information:

- Annual interest payment (I)
- Principal payment (P)
- Price of the bond (B)
- Number of years to maturity (M)

Using these values, calculate the approximate yield to maturity (YTM) using the following formula:

$$YTM = \{I + [(P - B) \div M]\} \div [(0.6 \times B) + (0.4 \times P)]$$

For example, what is the yield to maturity on a 12-year, 7-percent annual coupon, $1,000 par value bond that sells at a discount for $942.21? Here are the calculations:

$$YTM = \{70 + [(\$1{,}000 - \$942.21) \div 12]\} \div [(0.6 \times \$942.21) + (0.4 \times \$1{,}000)]$$

$$YTM = [70 + (57.79 \div 12)] \div (565.33 + 400)$$

$$YTM = (70 + 4.82) \div 965.33$$

$$YTM = 74.82 \div 965.33$$

$$YTM = 0.0775$$

$$YTM = 7.75\%$$

If your required rate of return is 8 percent, do *not* purchase the bond, because the approximate yield to maturity (7.75 percent) doesn't meet your financial requirements. Conversely, if the bond has a return equal to or greater than 8 percent, the bond meets your objectives and is a "buy" candidate.

Note: If the value of the bond is discounted (that is, sells below its par value — in this case, below $1,000), the yield to maturity (YTM) is greater than the 7-percent coupon rate.

More Online Bond News, Rates of Return, and Advice

For more information about bond markets, commentary, rates, and news, see the following online resources:

- **E*TRADE Canada (**www.etrade.ca**)** provides a daily and weekly Bond Market Commentary that includes financial data about bonds and discusses political, economic, and other events that can affect the price of bonds. Check out E*TRADE's Bond Centre page, where you can search out and buy from an inventory of more than 1,900 bonds and other fixed income securities. It's a great source for information about bonds.
- **SmartMoney.com (**www.smartmoney.com**),** shown in Figure 9-2, provides key interest rates, bond market updates, a bond calculator, and a glossary. Educational articles include bond strategies, short-term bond investing, bond allocation, and a bond primer. Yup, this site is the "James Bond" of bond sites.

Figure 9-2: Smart Money.com is a good place to find out more about bonds.

Where to Buy Bonds

Tens of thousands of Canadians own bonds of various stripes. In fact, over $1.2 billion of Canada Savings Bonds are sold each year. Three sources exist for purchasing CSBs and other bonds:

- **Banks, credit unions, and other financial institutions:** Many Canadian financial institutions are qualified as savings-bond agents. These agents accept the payments and the purchase orders for Canada Savings and other bonds, and forward the orders to the Bank of Canada (or, in the case of U.S. savings bonds, to a Federal Reserve bank).
- **Employer-sponsored payroll savings plans:** More than 5,000 Canadian employers participate in employer-sponsored payroll savings plans, and some chartered banks offer Canada Savings Bonds through instalment plans.
- **Federal Reserve banks:** If you want to buy U.S. savings bonds, you can write to a regional Federal Reserve bank and ask for an application. The Fed allows you (even though you are a Canadian) to purchase savings bonds by mail. A U.S. Savings Bond page can be found at the Web site for the Federal Reserve Bank of New York (`www.ny.frb.org`). This site provides the addresses of the 12 regional Federal Reserve banks. (Of course,

you can also buy U.S. savings bonds through most Canadian financial institutions.) You can also purchase treasury securities through the Fed's Internet purchase program, *Buy Direct!,* or by calling 1-800-943-6864. Tender forms and payments may also be submitted electronically through your financial institution or government securities broker or dealer.

How to buy 'em

You can get more information about buying and selling Canadian Treasury bills and Canada Savings Bonds by going to the Bank of Canada's Web site (`www.bankofcanada.ca`). You can even see if an unclaimed bank account or unredeemed bond is in your name!

Canadians who invest in U.S. treasuries and savings bonds can obtain all the order forms, instructions, auction dates, auction results, and other related information at the Bureau of the Public Debt Web site (`www.treasurydirect.gov/govt/govt.htm`). You can download and print forms, send e-mail requests for forms, or ask that forms be mailed to you. The ability to purchase U.S. treasury securities without a broker is a great money-saving feature for investors. Check out the special rules for Canadians who wish to buy U.S. securities.

Rolling over, cashing in, or selling your treasury securities

Canadian and U.S. Treasury bills mature at various intervals of time. When your Treasury bill matures, you have two choices. First, you can roll over your investment and reinvest in the face value of another T-bill (with the same or a different maturity). Second, you can cash in and have the proceeds deposited to your holding account. For example, say your $15,000 T-bill with a maturity term of 13 weeks matures. You can elect to reinvest in another $15,000 T-bill for 13, 26, or 52 weeks. If you choose not to reinvest your $15,000 at maturity, your holding account is credited with $15,000, or a cheque for $15,000 is sent to your home.

A third T-bill disposition option exists. You can sell your treasury securities before they mature, through a broker. But this will cost you extra money in commissions.

If you need to sell your U.S. treasury security, the U.S. federal government will help you. You can sell directly through TreasuryDirect — without a

broker. The government gets quotes from different dealers and offers you the best price. The fee starts at US$25 for each security sold, but many securities are also offered for free. You can even have the proceeds from the sale of the treasury security deposited directly into your chequing account, less the transaction fee. While you're at their Web site (`www.treasurydirect.gov/govt/govt.htm`), also check out their bond commentary and primers on treasury securities.

Book VI

Somewhere Over the Rainbow: Retirement Planning

The 5th Wave By Rich Tennant

"I've been working over 80 hours a week for the past two years preparing for retirement, and it hasn't bothered me OR my wife, what's-her-name."

Contents at a Glance

Chapter 1: Getting Started with Your RRSP 487

Chapter 2: What to Expect from Your RRSP 503

Chapter 3: Your RRSP Strategy 513

Chapter 4: Withdrawing Money from Your RRSP 529

Chapter 5: The Time Has Come to Cash In! 537

Chapter 1

Getting Started with Your RRSP

In This Chapter

- Understanding the basic principles and benefits of RRSPs
- Countering RRSP procrastination
- Calculating your maximum contribution
- Making regular contributions
- Claiming your tax benefit

Canadians may grumble about many government decisions, but Ottawa deserves a round of applause for creating the registered retirement savings plan (RRSP) way back in 1957.

By the way, an RRSP is not an insurance plan. It is not a savings bond. It is not a pension plan. And it is not a ticket that you buy today and present to the government when you are 65 years old, in return for a cheque and a pat on the head for being a good citizen.

An RRSP is an *investment.* Like all investments, it demands your attention from time to time. Also, an RRSP is not guaranteed to deliver X amount of money if you contribute Y dollars to it every year for Z years. Its growth will vary over the years, and the amount you have when you retire will be based on the amount of money you put into it, the number of years you keep adding to it, the attention you pay to managing it, the quality of advice you receive in caring for it, and, like it or not, a smattering of good luck.

Basic Principles of RRSP Investing

One of the joys of managing your RRSP is the satisfaction you gain from taking control of your financial future. This needn't be as complicated as you may expect.

It begins with three basic principles of investing. You can apply variations to these according to your own interest and comfort level, but understanding and applying these three concepts is the secret of investing success:

- **Diversification:** This is just another way of saying "Don't put all your eggs in one basket." If you invest all of your RRSP contributions, for example, in 5-year GICs paying 6 percent annually, you might feel pretty smug . . . until you discover at the end of the 5 years that the stock market rose an average 12 percent annually over the same period. And if you sank every RRSP penny into shares of a South Korean manufacturing company, the Asian financial crisis of 1998–99 would have had you lying awake at night in a cold sweat, watching your hard-earned dollars sink in value.

  The solution is to *diversify* your RRSP among various investment alternatives including GICs, bonds, equity-based investments (meaning you own shares in companies traded on the stock market), and other alternatives. Diversification adds security to your RRSP and lets you sleep better at night. You need a minimum amount in your RRSP to take advantage of diversification — $10,000, say — and a formula based on your own comfort level. Here's the guideline to help you craft your own diversification formula: The percentage of "guaranteed" investments — GICs, T-bills, bonds, and so on — held in your RRSP should not exceed your age until you're within sight of retirement. It's just a guide, of course, but a good one to remember.

- **Liquidity:** Having a $1,000 diamond ring on your finger is not the same as having a certified cheque for $1,000 in your pocket. While their value may be identical, the cheque is much more *liquid* than the diamond ring, which means it can be converted into cash more easily. Keeping a portion of your RRSP in liquid investments makes it easy to withdraw money from your RRSP to meet an emergency or for certain qualified reasons. Liquidity grows more important as you near retirement, but it also enables you to change the recipe of your RRSP investment, which means you can diversify your investments more easily.

  Savings accounts, short-term GICs, T-bills, government bonds, and certain kinds of mutual funds provide high liquidity. You pay for this convenience with generally low returns from your investment.

- **Growth versus income:** Think of two kinds of trees — an oak tree and an apple tree. If you plant the oak tree and your sister plants the apple tree, you'll each benefit in different ways over the years. You can watch the oak tree grow steadily taller until it becomes a strong, sturdy source of shade and, eventually, wood that you can use to heat your home or build furniture. Meanwhile, your sister will be harvesting apples each year.

  Some investments are like that — one provides long-term growth, and the other rewards you on a regular basis over the years. Generally, the younger you are the more focused you can be on growth. Combining both, by the way, is one more kind of diversification.

Excuses, Excuses

In spite of the benefits of an RRSP, many people choose to ignore them. It's always easy to find reasons for justifying this attitude. How many of the following excuses have you heard . . . or used?

- I'm too young or too old
- I just got married
- I just got a mortgage
- My house is my retirement plan
- My spouse/partner has an RRSP
- We're starting a family
- I can't afford it
- I can't get money out of my RRSP if I need it
- RRSPs are too confusing

Here are some powerful counterarguments to these excuses:

"I'm too young." No, you're not. If you're old enough to read this book and have any source of income, you're old enough to make an RRSP contribution. Sure, retirement is many years away. But look at your RRSP contributions as a form of savings. Over the years, you'll receive great satisfaction in having those funds tucked away where the Canada Revenue Agency (CRA) can't get at them, and where they'll eventually grow by leaps and bounds. You're never too old for an RRSP as long as you or your spouse is less than 71 years old and you have "earned income."

"I just got married." Now that the honeymoon is over, it's time for you to face reality. The CRA, you may have noticed, didn't send you a wedding gift and doesn't offer special breaks to married couples. For example, unlike U.S. citizens, Canadians cannot file a joint tax return, dividing their income and lowering their marginal tax rate. But you can both benefit from an RRSP, beginning right now. If one of you is earning substantially more than the other, consider a spousal RRSP. (See Chapter 2 for details.)

"I just got a mortgage." That's a long-term financial commitment. Over the years, your mortgage will slowly decrease with each payment. If you are able to set aside even a small amount — as little as $50 each month — you can begin building an RRSP, which will move in the opposite direction as your mortgage, growing in value as the mortgage shrinks. Imagine the day when your mortgage is finally paid off and your RRSP is in the six-figure range, ready to provide you with a comfortable income. Imagine the good feeling

you'll have. (And don't forget those tax advantages.) When your RRSP is big enough, you can invest it in your own mortgage.

"My house is my retirement plan." A house isn't a retirement plan — it's shelter and warmth, with a little pride thrown in. Real estate booms (along with a few aggressive real estate agents) convince many Canadians their home isn't just their castle but the foundation of their investment portfolio. This is nonsense, as anyone caught in a bursting local real estate bubble can attest to. If you suddenly need the cash that's locked into your house, being caught in a downward real estate cycle can cost you a lot of money and heartache. This is by no means a warning against owning your own home. In fact, owning good properties is a good thing. But as a source of retirement income, it doesn't compare with a liquid and flexible RRSP. You buy your home with *after-tax dollars* (what's left of a loonie when federal and provincial income tax has been deducted); you invest in an RRSP with *before-tax dollars* (the money you've earned and expect to keep).

"My spouse/partner has an RRSP." All right, let's get brutal about this. First, it's lovely to assume you and your partner will spend the rest of your lives together, but that's still just an assumption. Canadian family law provides for an even distribution of assets, including an RRSP. This means that, in the event of a separation, each of you owns half the RRSP benefit you need. Next, if both of you have earned income, you are jointly enjoying only half the tax benefit available to you. Everyone with earned income should have an RRSP. There's plenty of upside and virtually no downside.

"We're starting a family." Somewhere amid expenses for diapers, toys, clothing, daycare, and other associated costs, try to find a few dollars for an RRSP. Parents do themselves and their children a favour by acquiring a savings habit and sharing it with their kids. When your offspring are old enough, you can explain how the money is contributed and invested, and together you can watch how it grows over the years. This will make it easier for your children to pick up the habit for themselves, including opening their own RRSP. Besides, think how much peace of mind they'll enjoy knowing Mom and Dad will face retirement with adequate assets . . . meaning you won't be a burden to them in the future.

"I can't afford it." This is one we can all relate to. Each of us has limits on the amount of money left over after taxes, rent or mortgage payments, food, transportation, and so on. Here are three ways to deal with this particular excuse:

- It doesn't take much to get started — as little as $50 each month, for example, will enable you to invest. That's equivalent to the cost of a coffee and doughnut each working day. Invest the money in an RRSP and you'll improve your financial outlook and (probably) reduce your waistline.

- Arrange an automatic RRSP contribution through your employer (called a *source deduction*), bank, trust company, or credit union and reduce the impact on your budget. If you prefer to have your employer handle the paperwork, call your local CRA office and ask for a source-deduction form. You and your employer complete the form and your employer forwards it to the CRA.
- If taxes are the biggest single bite out of your income each month, isn't that the best place to begin saving money? An RRSP enables you to reduce your taxes while saving money. What's more, if you qualify for a tax refund, you can use it for part of next year's contribution.

"I can't get money out of my RRSP if I need it." Any good RRSP portfolio can be turned to cash in three business days. Not a good move, but it can be done. You can get an RRSP on Monday and cash it out on Tuesday if you have to do so. If you keep an RRSP for a long while, then you win. If you keep an RRSP for a short while, then you usually break even.

"RRSPs are too confusing." Not anymore. That's why you're reading this book, remember?

Determine Your Maximum Contribution

The federal government places no limits on the amount of money you can accumulate tax-free inside your RRSP, but it limits the amount you can contribute into it each year. This amount is based on your earned income for the previous year. Because many people often spend too much at Christmas, RRSP rules permit contributions made through the end of February to be claimed against the previous year's income. This fits neatly between the end of the calendar year and April 30, the deadline for filing your income tax return. Most Canadians don't get around to making their RRSP contributions until around Groundhog Day, which is why everyone living between Newfoundland and Nanaimo cannot escape being bombarded with RRSP information from banks, trust companies, mutual funds, and probably Cousin Fred between Christmas and March 1.

Of course, you needn't wait until the end of February to make your RRSP contribution. You can actually put money in your RRSP as early as January 1 of the previous year. That gives you 14 months to act — from January 1 of one year all the way to February 28 of the following year (or February 29 or March 1 if February 28 falls on a weekend). By acting sooner than the deadline, you avoid the traditional rush and panic. And by investing the funds 14 months earlier, you get an extra year's growth. Over 25 years or so, the benefits of this extra year can mean literally tens of thousands of dollars more in your RRSP.

You can contribute the lower of these three figures each year:

- 18% of your earned income from the previous year
- The maximum amount as shown in the chart below:

Year	*Amount Allowed*
2007	$19,000
2008	$20,000
2009	$21,000
2010	$22,000 (after 2010 the annual maximum contribution rate will be indexed to wage growth statistics)

- The amount of contribution room left after your employer has made a contribution on your behalf. Here's how that works: If you're a member of a company pension plan or deferred profit-sharing plan (DPSP), your maximum RRSP contribution is reduced, because it would represent a major unfair advantage to you over those Canadians who are unable to participate in such plans. This includes people such as wretched, ink-stained, freelance writers, for example, which means this is one Canada Revenue Agency ruling with which those of us who took part in the creation of this book have absolutely no problem. . . .

Canada Revenue Agency limits

Each spring and summer, the Canada Revenue Agency sends all taxpayers a *Notice of Assessment,* which establishes the maximum contribution you are allowed for the current year. So, an assessment you received in June 2008 would show the maximum you're able to contribute and deduct from your 2008 income for tax purposes. Remember, you will have until the end of February 2009 to make the contribution and until the end of April 2009 to file your tax return.

The CRA's Notice of Assessment includes their evaluation of any retirement benefits you earned from being a member of a company pension plan or DPSP. This evaluation, and its impact on your RRSP contribution limit, is called your pension adjustment, or PA factor. Subtracting the PA factor from 18 percent of your taxable income produces the maximum RRSP contribution permitted to you.

The PA factor changes according to the type of pension plan or DPSP your employer provides:

- A *defined benefit plan* pays you a retirement income based on your years of service with the company and your income level. Your PA factor with a defined benefit plan is calculated according to the future value of the plan, using your previous year of employment.

- A *defined contribution* or *money purchase plan* has no fixed benefit when you retire. You and your employer both contribute to the plan each year, and the amount of income paid to you by the plan when you retire is dependent on the total value of the plan at that time. If you belong to this type of plan, your maximum RRSP contribution will be 18 percent of your earned income less the amount contributed to the plan by both you and your employer.
- A *deferred profit-sharing plan* is built up from money placed in the plan by your employer, based on the company's profits for that year. Your PA factor under this plan will equal the total DPSP contribution (up to a maximum limit) made on your behalf. This will be subtracted from 18 percent of your earned income for that year.

Table 1-1 illustrates examples of income levels and contribution limits for four individuals with varying incomes.

Andy had $30,000 earned income in 2007 and belongs to no pension plan.

Allison had $40,000 earned income in 2007 and belongs to a money purchase pension plan. Between them, she and her employer contributed $2,500 to her plan in the same year.

Arthur had $75,000 earned income in 2007 and belongs to a DPSP. His company contributed $5,000 to his DPSP in 2005.

Amanda had $145,000 earned income in 2007 and belongs to no pension plan.

Table 1-1 Maximum RRSP Contributions, 2007

Name	*Income*	*PA Factor*	*Maximum*
Andy	$30,000	N/A	$5,400
Allison	$40,000	$2,500	$4,700
Arthur	$75,000	$5,000	$8,500
Amanda	$145,000	N/A	$19,000

Calculating Andy's maximum RRSP contribution is easy — 18 percent of $30,000.

Allison's maximum contribution was reached by taking 18 percent of her earned income — $7,200 — and subtracting the total contributions to her money purchase pension plan from that amount, leaving $4,700.

Arthur's RRSP contribution was reached by subtracting the $5,000 earned by his DPSP from 18 percent of his earned income (18 percent of $75,000 = $13,500), for an $8,500 maximum.

Amanda did very well — but 18 percent of her $145,000 earned income exceeds the $19,000 maximum for 2007. Even if Amanda made a million dollars in 2007, she would be restricted to $19,000.

The maximum RRSP contribution is scheduled to climb by $1,000 per year for a while, and assuming the same income and PA factor figures apply, Amanda will be able to contribute up to the higher maximums in those respective years. For Andy, Allison, and Arthur, there will be no change, again assuming the same figures apply.

The maximum RRSP deduction limit for 2007 is $19,000. However, if you didn't use all of your RRSP deduction limit for the years 1991–2007, you can carry forward the unused amount to 2008. Therefore, your RRSP deduction limit for 2007 may be more than $19,000. The maximum RRSP deduction limit for subsequent years is $20,000 for 2008 and $21,000 for 2009.

A little room for going over the limit

Believe it or not, the folks at Canada Revenue Agency agree that we live in an imperfect world. Mistakes can be made. Rules can be changed. Murphy's Law can still apply. And any one of us, or even the CRA itself, can miscalculate now and then and — horrors! — contribute more money to an RRSP than is allowed under the rules.

That's why Canadians are permitted to contribute up to $2,000 more than allowed in any taxation year. If this occurs, you simply deduct the overcontribution from the amount permitted in the following taxation year.

For example: If your RRSP contribution limit for one year, based on 18 percent of your earned income less any PA factor, is $5,000, you are allowed to contribute up to $7,000 without penalty. If you do so, and your RRSP limit remains at $5,000 for the following year, the $2,000 overcontribution is subtracted from that year's $5,000 contribution limit, reducing the limit to $3,000. If you think you can deduct the entire $7,000 from your earned income, generating a fatter tax refund, forget it. You cannot deduct more than your limit — in this case, $5,000. (However, if the extra $2,000 you overcontributed is invested early and wisely within your RRSP, you enjoy the benefit of positive tax-free returns.) You can apply the overcontribution to the following year, however. So, for tax purposes, your $3,000 allowable contribution in 2002 becomes a $5,000 deduction from earned income in that year, because you have carried forward the overcontribution.

What happens if you overcontribute more than the $2,000 limit? Ottawa gets nasty, that's what. You must withdraw the excess funds from your RRSP before you can claim any further contributions to it. And to make its point, the CRA slaps a penalty of 1 percent per month on overcontributions made beyond the $2,000, until you get it out of your plan.

By the way: No one under 19 years of age is permitted to overcontribute to their RRSP. One more source of adolescent angst. . . .

If you are currently employed and plan to retire in the next few years, you may be eligible to place a *retiring allowance* in your RRSP. A retiring allowance is any money awarded to you by your employer when you leave work permanently for any reason. It includes payments made to you in recognition of your years of service, as well as any unused sick-leave pay; it does not include unused vacation benefits.

The formula is a little complex because Ottawa has tinkered with the rules over the years. It works like this: For each year of service between 1989 and 1995, you're allowed to contribute up to $2,000 to your RRSP beyond your normal contribution limits within 60 days of the end of the year in which you received the retiring allowance (basically, the same time frame used for standard RRSP contributions).

For each year of employment prior to 1989 in which your employer did not make contributions to a pension plan on your behalf, or did not make deposits in a deferred profit-sharing plan, you are permitted an additional $1,500 contribution.

Here's why it pays to see your accountant before transferring a substantial amount of money from a retiring allowance to your RRSP: The amount of the retiring allowance transferred to your RRSP does not affect the calculation of your RRSP contributions for that year. But any portion of the allowance transferred to an RRSP and claimed as a deduction must be added back to your taxable income for the purpose of calculating the alternative minimum tax (AMT), which has a basic deduction of $40,000. If AMT is payable, it can be recovered up to seven years in the future to the extent, in any year, that your income tax liability is greater than the AMT liability. So you could face some unexpected taxes unless you obtain qualified advice.

Accountants know all about this stuff. Thank goodness.

Years of employment after 1995 do not qualify you for any retirement allowance contributions, and any part of a calendar year is counted as a full year. An example:

Sam began working for a small-town daily newspaper in October 1963 and retired in March 1991. The newspaper maintained no formal pension plan but awarded lump-sum payments and credited sick leave not taken during employment. Sam's 28 years of employment thus qualified him to contribute 28 (total years of employment) × $2,000 + 26 (years of employment without a pension plan prior to 1989) × $1,500 = $95,000. This amount, shown on Sam's last T4 slip, will be offset by a standard RRSP contribution receipt.

A second chance to contribute

The most common problem people encounter, especially in the early years of their career, is not contributing too much to their RRSP but rather contributing too little. Fortunately, the Canada Revenue Agency provides a break by permitting you to catch up with bigger contributions later. If your contribution limit for this year is $7,500 and you can only afford to contribute $5,000, the $2,500 difference isn't lost; it's *carried forward* indefinitely in something called an *unused deduction limit.* Next year, or at any year in the future, you can add the amount in your unused deduction limit to your new deduction limit and increase your contribution. So if next year's contribution limit remains at $5,000, you are eligible to carry forward the $2,500 from the previous year, contribute $7,500, and deduct the full amount from your taxable income.

Wherever possible, however, it's best to maximize and start enjoying the benefits of tax-free compound interest growth from the earliest possible date.

Is it possible to justify contributing less than the maximum RRSP contribution, even when you can afford it? Perhaps. For example, you could use part of the money set aside for your RRSP to pay down a high-interest credit card balance instead. Some credit cards carry an 18-percent interest rate, and it's difficult to obtain that kind of growth from investments these days. You can always catch up in the future, using your unused deduction limit.

But if you do, you're losing both the tax-deduction benefits of an RRSP and delaying the tax-free compound growth. Here's an even bigger concern: Governments, you may have noticed, have a habit of changing rules that benefit taxpayers. Nowhere is it written that the carry-forward option for RRSPs will remain part of the RRSP program forever. If the federal government chooses to eliminate this rule sometime in the future, those delayed contributions will be gone and you will have no chance to catch up. Ever.

So, as Janis Joplin used to advise (in a slightly different context): Get it while you can!

The Foreign-Content Factor: R.I.P.

For many years, the portion of investments in your RRSP located outside of Canada was severely restricted. From a maximum of 10 percent, the limit was raised first to 30 percent and eventually discarded entirely. Now you face no limits to the portion of your RRSP invested in mutual funds or corporate shares located beyond our own borders.

Is this a good thing? Well, mostly yes and a little bit no.

Investing outside of Canada is an effective method of diversification. Canada represents barely 4 percent of the world's total value of traded stocks, so to invest exclusively at home is to place all of your eggs in a very small basket. This is made more critical by the nature of the Canadian economy and the way it has changed in recent years. Steelmakers such as Dofasco and Stelco, and mining giants Inco and Falconbridge, were once Canadian corporations. Now they are foreign, and their exodus has limited the industrial base of our country as far as domestic investment is concerned. The two biggest industries available for domestic investments in Canada are finance (those giant money-making banks) and energy, especially petroleum.

The small downside to unlimited foreign investment concerns currency fluctuation. Any change in the value of the Canadian dollar affects the value of your foreign investment, which rides the opposite end of an unpredictable teeter-totter. During the mid-to-late 1990s, when the loonie plummeted against the U.S. greenback, every drop in our dollar raised the value of investments in the United States. When things turned around after 2000, however, the shoe was on the other foot. More correctly, the hand was in the other pocket. As the loonie rose against the U.S. dollar, American investments fell in value.

Currency changes are neither good nor bad news. They're simply unpredictable. Nothing is for sure, but every element in your RRSP investment that defies reasonable predictability is another measure of risk.

Monthly Contributions versus Lump-Sum Payments

The first wise decision you can make in providing yourself with future financial security is to open an RRSP, if you haven't already. The second wise decision you can make is to arrange regular contributions each month throughout the year instead of waiting to make a lump-sum contribution at the last minute — like, ten minutes to midnight on February 28.

What makes this such a wise decision?

First, monthly contributions become almost painless. It's much easier to adjust your budget to 12 relatively small amounts over a full year than to absorb a major *whack!* each February.

Next, regular contributions give you an opportunity to ponder where and how to invest your RRSP contributions. Last-minute decisions tend to be second-rate decisions, and if you don't make up your mind where to invest your money until the late-February, last-minute rush each year, the growth of your RRSP is sure to suffer.

Finally, monthly contributions enable you to benefit from dollar-cost averaging, a neat trick where you make your investment over a series of year-round equal payments. Because no one is wise enough to recognize the bottom price of any mutual fund or common share (that is, the best time to leap into a growing market), or wise enough to know when the top price has been reached (that is, the best time to get out while the gettin' is good), dollar-cost averaging is the next best thing. When unit prices are lower you purchase more shares, and when the prices are higher you acquire fewer shares. And you are able to accomplish this trick because you're investing a regular series of equal payments that purchase shares when the market is high or low.

If you must make a last-minute, lump-sum contribution, by all means do so. But try to adapt to regular monthly contributions if possible.

Will two people, contributing exactly the same amount of money to their RRSP and investing it exactly the same way, have identical RRSP values? Not necessarily.

If you make a lump-sum payment at the end of the year in December, and your twin sister contributes the same amount 12 months earlier in January, you both qualify for the deduction in the same year. But your sister's 12-month head start means her RRSP will grow faster as time goes by. How much faster?

Assuming you each contribute $1,000 annually and earn interest at 10 percent, at the end of five years your RRSP is worth $6,105 and your sister's has a balance of $6,715. After ten years, your sister has $17,531 in her RRSP while you have just $15,937. And if you both maintain the same contribution level and earn the same annual interest, after 30 years your sister's RRSP will have a value of $180,943 compared with your $164,494. The difference? The 12-month head start she took each year. And that $15,000 advantage could generate enough retirement income for your sister to enjoy a few weeks in Florida each winter, leaving you back in Canada to shovel snow and read her gloating postcards.

Deductions at source

If your employer automatically deducts income tax from each paycheque, your deductions are made *at source.* This is also an easy and more convenient way to make regular contributions to your RRSP throughout the year. While you won't enjoy the delicious but illogical thrill of receiving a fat tax refund each spring, unless you make a lump-sum supplementary contribution (assuming you have RRSP limits), your net pay, including your RRSP contribution, will

be increased. That's because your employer will be authorized to lower your income-tax deductions to reflect your RRSP contributions.

It is up to you, not your employer or the Canada Revenue Agency, to take the initiative to have your employer reduce your income tax with each paycheque, reflecting your monthly RRSP contributions. Write to the source deductions division of your district taxation office (your employer can provide the address) and ask the CRA to authorize the lower tax level. Include details such as the full address of your employer and a copy of a receipt confirming your RRSP contributions issued by the bank, trust company, credit union, mutual fund, or other holder of your RRSP assets. Be sure to mention other sources of earned income if you have any.

When the CRA is satisfied that your request qualifies, they will authorize your employer to reduce the income tax withheld from your paycheque each month, boosting your monthly take-home pay.

If you belong to a group RRSP administered by your employer, the income tax payments withdrawn from your salary already reflect your RRSP contributions. No need to alert the CRA.

Borrowing to save

The idea of borrowing money in order to save it doesn't make sense unless you save it in an RRSP. If borrowing is the only way to max out your RRSP contribution for the year, it becomes a very attractive move *provided you pay back the loan in a year's time.* You are no longer allowed to deduct the interest on money you borrow to make an RRSP contribution. (Until 1981, you were. See what is meant about the feds changing the rules now and then?) But borrowing the money to make your RRSP contribution is a much wiser move than making no RRSP contribution at all. And if you have put off making a contribution until the RRSP deadline, it makes even more sense.

Suppose it's mid-February and you want to contribute $5,000 to your RRSP before the February 28 deadline arrives. If you're in a 40-percent marginal tax bracket, the $5,000 deduction will earn you a $2,000 tax refund when you file your return in April. Hey, don't pass it up! So what do you do? You visit a local bank, trust company, or credit union, and tell them you want to borrow $5,000, which you will invest in an RRSP with their organization. You want to spread payments over 12 months, you expect to receive a favourable interest rate, and you would be especially pleased if they would delay the due date of the first payment by three months. If you're a local resident, steadily employed, and have a credit rating at least as good as your dog's, the financial institution

will agree to these terms. If they don't, walk out the door and visit another bank/trust company/credit union and ask for the same terms. You'll get them.

When the paperwork for the $5,000 is finished, assign it to an RRSP with the same people who loaned you the money. They will issue a receipt entitling you to deduct the entire $5,000 from your tax return. (You may have to wait two weeks or more for the receipt to arrive.) Based on your 40-percent marginal tax rate, this will generate a $2,000 refund from Canada Revenue Agency — which, if your timing is good, arrives in the mail around the same time your first loan payment is due. Apply the entire amount to the loan balance, and you now have $5,000 in your RRSP and owe just $3,000 to the lender.

There's more. You'll be paying interest on the balance, and the annual interest percentage will likely be more than your RRSP earns over the year. But *you are paying interest on a declining balance for your loan;* each monthly payment reduces both the amount you owe and the interest you pay. Meanwhile, *the $5,000 in your RRSP is earning interest on a rising value.* After six months, for example, the balance of your loan could be just $1,500 (assuming you applied your tax refund to the original amount) and the value of your RRSP could be $5,125. In another six months your loan will have vanished. But the $5,125 in your RRSP is like that pink bunny with the drum. It keeps growing and growing and growing. . . .

RESPs

A recent Canada Revenue Agency wrinkle provides another source of RRSP contributions to some people under certain circumstances. It concerns registered education savings plans (RESPs), created to help parents and grandparents save for a child's education. RESPs have been around for a few years, but a change in the rules now benefits RRSP holders.

Previously, if funds in an RESP were not used by the designated child for postsecondary educational purposes, the contributor to the plan could recover only the money invested in it; all other funds went to the government. As of 1999, if the RESP beneficiary chooses not to obtain a postsecondary education, contributors can roll the entire value of the plan, up to a maximum of $50,000, into their RRSP or a spouse's RRSP, provided the plan is at least ten years old and a sufficient contribution limit exists in the designated RRSP.

Catching up big-time

Some banks offer RRSP loans that enable you to catch up on the unused contribution limit you may have created over the years. You can actually get

your hands on as much as $50,000 for this purpose, although $15,000 to $20,000 is more realistic. What's more, you can take up to 15 years to repay the loan. Is this a good idea?

It depends. If you're in a 40-percent tax bracket, a $15,000 catch-up contribution — making up for several years when you failed to make the maximum contribution permitted each year — will produce a $6,000 tax refund. If you apply this to the loan and reduce the balance to $9,000, if the bank or trust company agrees to charge interest at *prime rate,* and if you stretch the payments over 15 years, your monthly payments might be a tolerable $175. Meanwhile, your RRSP balance is immediately $15,000 fatter and grows free of tax.

Sounds good. But remember you'll be paying back close to $2,000 in loan interest over the years, which is $2,000 unavailable for future RRSP contributions. Remember too that a bank's prime rate can fluctuate. Any significant rise in interest rates will boot your monthly payments higher, which could put a strain on your cash flow.

The bottom line? Weigh your options, measure your confidence level about future earnings, and be sure to shop around. RRSP loans to people with good credit ratings are considered very low risk, so you have a right to demand the lowest available interest rate.

The reason this usually works so well is that your borrowing rate is much lower than your tax rate.

Claiming Your Deduction

Making an RRSP deduction makes you feel good twice. First you feel good soon, when you receive your tax-refund cheque from Canada Revenue Agency. Then you feel good later, when your RRSP contributions have grown over the years into a healthy nest egg.

But believe it or not, a way to feel even better about your refund exists. Here's how it works:

The CRA does not insist you submit your RRSP contribution receipt, qualifying you for lower taxes, in the same tax year in which you made it. You can, if you wish, tuck the receipt into your sock drawer and leave it there for a few years. Why in the name of the Minister of Finance would you want to do this? Because it could earn you a bigger deduction later.

Suppose your earned income was $30,000 this year, and you made a $2,000 contribution to your RRSP. That income level puts you in the 28-percent tax bracket, so the $2,000 contribution produces a $520 tax refund ($2,000 × 28 percent). But you're confident your income will rise to $40,000 over the next year or two, placing you in the 40-percent tax bracket. Now the $2,000 contribution produces an $800 tax refund ($2,000 × 40 percent), or $280 more. That's not a bad deal.

People who take time from work to enjoy a sabbatical or to have children can also benefit from delaying their deduction. While taking time off and earning little if any income, limited benefit exists in claiming a deduction. But back at work again, when the income level jumps, the RRSP receipt pays off with a bigger deduction.

Both of these situations — a potentially much larger annual income in a year or two, and a return to full employment — can justify a delay in claiming your RRSP deduction.

Is there a downside? A downside always exists in life. Instead of waiting, you could claim your deduction now and use an immediate tax refund to pay down high-interest credit card balances — always a smart move — or invest the money outside your RRSP. You also risk falling prey to the dreaded "Close the loophole!" cry from Ottawa, which means they yank back something they awarded you in the past before you have had a chance to enjoy it — in this case, the opportunity to claim delayed deductions.

Chapter 2

What to Expect from Your RRSP

In This Chapter

- Calculating growth over the years
- Dealing with inflation
- Determining how much to accumulate
- Nurturing your investment
- Finding out what's attractive about spousal RRSPs
- Using your RRSP as collateral
- Understanding what happens to your RRSP if you leave the country

Contributing as much as you can afford to your RRSP year after year is one heck of a good idea, as you have probably figured out if you've read this far. But growing your RRSP isn't like raising mushrooms in your basement; you can't just toss a shovel or two of goodies at it from time to time and assume it'll take care of itself.

Making regular contributions is only the first part of your plan. The second part is finding ways to maximize the growth of your investment, year after year. This is the part that makes many Canadians nervous or confused, and perhaps a bit of both. A successful RRSP strategy requires work, and that turns off a lot of people. Unless you already have some investment experience, the very mention of terms such as *diversification, debt instruments, asset allocation,* and *equities* can make your eyes glaze over.

The responsibility of making decisions about their RRSP frightens some people. Mention mutual funds or stock markets to many Canadians, and they picture a giant neon sign flashing "Risk! Risk! Risk!" in red letters. Too bad they can't see the other side of that sign. It glows in a rich, gold colour and spells out "Reward! Reward! Reward!"

Don't be intimidated by the fear of risk. You can't avoid it entirely. But you can manage it to your benefit. How?

- **By getting to know some basic rules:** The investment options you face are not all that complex, and the principles are easy to grasp by anyone who can read a bank statement.
- **By understanding the principles of basic investing:** Using this knowledge to make wise decisions can make an astonishing difference to the value of your RRSP.
- **By realizing that taking charge of your investments can be both satisfying and fun:** You can take comfort in the rewards of making good decisions, and gain experience when your decisions don't pay off quite as well as you hoped.

Actively managing your RRSP by applying basic investment principles, supported by qualified professional assistance, will produce results far richer in the long term than an RRSP consisting entirely of cash savings, guaranteed investment certificates (GICs), and guaranteed bonds. Count on it.

Growth Expectations

When RRSP owners realize the impact of potential long-term growth, they usually become enthusiastic about taking charge of their investments, seeking to eke out an extra 2 or 3 percent advantage each year. Perhaps a 2 percent improvement doesn't sound all that impressive to a baseball player's batting average. But over the long term, an RRSP earning 12 percent annually instead of 10 percent can make the difference between a "getting by" retirement and a near-luxurious lifestyle.

How much difference can your RRSP decisions make to the amount of money you have when you retire? Check out Table 2-1.

Table 2-1 Impact of RRSP Investment Decisions Original Investment: $5,000

Investment	*Percentage Growth*	*10 Years*	*30 Years*
Canada Savings Bonds (CSBs)	6.5%	$9,385.69	$33,071.83
Canadian stock market	8.8%	$11,621.41	$62,782.25
International stock market	11.0%	$14,197.10	$114,461.48

If you had invested your RRSP in eligible Canada Savings Bonds ten years ago, your RRSP would have produced growth of 6.5 percent each year since you bought the bonds. Not bad? Consider this: Money invested in a typical Canadian equity-based mutual fund would have returned an average growth of 8.8 percent each year, a 2.3 percent annual improvement over the bonds. And the same amount of money invested in a typical international equity-based mutual fund would have awarded you a whopping 11.0 percent average annual return over that same ten-year period.

A $5,000 investment growing at 6.5 percent annual compound interest would grow to $9,385.69 over this ten-year period. The same amount of money growing at 8.8 percent annually over the same ten-year period would be worth $11,621.41.

And if you could earn 11 percent from your $5,000, you would have $14,197.10. The difference over 30 years is even more impressive.

So don't consider a 2 or 3 percent improvement in your RRSP growth insignificant. Over the long term, that kind of advantage can be a gold mine.

The Spectre of Inflation

Back in the days of the voyageur fur traders, North American native tribes believed an evil spirit prowled the northern woods. On the coldest, darkest nights of the year, the spirit would emerge from the forest and devour all the food gathered by the tribe to sustain them through the winter. If it were famished enough, the spirit would begin consuming the people themselves. Only when the beast was satisfied did it return to its hiding place. The tribes would take a long time to recover, and they would never forget the evil spirit, lurking somewhere in the darkness, ready to creep back into the village at any time.

Economists and investors fear a similar legendary beast, called inflation. From time to time the inflation beast arrives, and the devastation is massive. Its last appearance was in the early 1980s, when interest rates shot beyond the 20 percent level, leading to business failures, mortgage foreclosures, and financial disaster for anyone living on a fixed income, other than those who lived on interest income that was fixed at high rates! Inflation leads to higher prices for goods and services, which triggers demands for higher wages and salaries, which produces higher prices . . . and the merry-go-round keeps spinning.

Large-scale inflation is created by a number of factors that are fascinating to economists and as interesting as a pile of bricks to the rest of us. Fortunately, the last decade has seen relatively low rates of inflation, averaging

about 2 percent per year. The world economy may be able to sustain these low rates indefinitely, or so we hope — other than those who rely on income generated by high interest rates!

But inflation is always around in small amounts, and even low levels can affect your long-term RRSP goals. Just as the 2 percent difference is a long-term shot in the arm to the growth of your RRSP, a steady 2 percent rate of inflation means you'll need substantially more money in the future to enjoy the same degree of comfort you experience today.

Suppose you plan to stop working in 20 years, and you estimate that a retirement income of $40,000 a year should do just fine. Sounds good. But you're measuring that income with *today's* dollar value. Over time, inflation lowers the value of every dollar you earn or accumulate each year. If inflation averages 3 percent annually over the next 20 years, the lifestyle you can enjoy today with a $40,000 annual income will cost you $72,244 a year when you retire. If inflation jumps to an average of 5 percent annually between now and then, you'll need $106,132 a year to enjoy a life that costs $40,000 annually today (see Table 2-2). By the way, historically our economy has endured an average 5 percent annual inflation rate.

Table 2-2 Income Growth to Match Inflation
Amount Needed to Match $40,000 Income Today

Inflation Rate	*5 Years*	*10 Years*	*15 Years*	*20 Years*
3%	$46,371	$53,757	$62,319	$72,244
4%	$48,666	$59,210	$72,038	$87,645
5%	$51,051	$65,156	$83,157	$106,132

Don't fret — inflation also brings a few investment opportunities with it. But the long-term impact of even relatively low levels of inflation should alert you to two rules of life, retirement, and the whole darn thing:

- Maximize the contribution level and growth of your RRSP.
- Actively manage your RRSP so that you can respond to unforeseen events and opportunities.

How Much Will You Need?

Of all the questions asked by RRSP investors, this is perhaps the most difficult to answer. Why? Because it involves so many variables, including the following:

- **Your life span:** How long do you expect to live after retirement? (***Note:*** "As long as possible" doesn't count.)
- **Your age when you will retire:** Will you be 55? 60? 65? Older?
- **Your retirement lifestyle:** Will you read and garden? Travel often as globetrotters? Remain in your own home, or sell it and move to smaller, less expensive quarters? Do you plan to work part-time?
- **Your financial situation:** Will your home be mortgage-free, or will you still be making those pesky payments? Will you be facing substantial balances on high-interest credit cards?

The answers to these questions are yours to determine. No "one size fits all" secret exists to estimating the retirement income you'll need. All you can do is accept some basic assumptions and proceed from there, making adjustments as you go along. Here are a few guidelines that most economists and financial advisers agree upon:

- **Expect that you will need only 70 percent of your current income to sustain the lifestyle you enjoy today.** Some advisers say 80 percent, and others suggest as low as 40 percent, depending on the lifestyle you choose. Remember, you'll be spending less on job-related expenses such as clothing, commuting, and lunches. A paid-up mortgage and grown children will cut your living costs even further. So 70 percent of what you currently earn makes a reasonable figure for a comfortable retirement.
- **Assume at least some income from government sources.** Current maximum Canada/Quebec Pension Plan benefits for those retiring at 65 are about $10,000 annually. Start drawing benefits at age 60 and it drops to around $7,000 a year; delay retirement to age 70 and it rises to the $13,000 level. The timing of when you may choose to trigger your retirement benefits is a very important consideration.
- **Plan on living to the ripe old age of 90.** A few generations ago, this was a rare life expectancy for Canadians. But given better medical care and the awareness of maintaining a healthier lifestyle — no smoking, regular exercise, annual check-ups, and improved diet — it's not such an outrageous goal at all! In fact, strive for it! So if you retire at age 55 this means 35 years of retirement ahead of you, which may be longer than your entire working career.
- **Assume a conservative return on your RRSP balance after retirement of 8 percent annually and an average annual inflation rate of 5 percent.** This will generate an average 3 percent in annual growth *after* inflation. Now estimate the retirement income you'll need — say, $40,000 per year, plus any government benefits listed above — and multiply by 25.

Hang on, because the answer to how much you'll need is $1 million. But depending on your age and your determination, this is not quite as unreachable as you may think. If your current age is 25 and you're able to generate a

conservative 8 percent growth from your RRSP, it takes an annual contribution of $3,860 to reach that magic million at age 65. Earn 12 percent each year from your RRSP — not an unreasonable level over the very long term — and you need only $1,300 each year in your plan.

If you're currently 35 years old, you'll need to sock away $8,830 each year earning 8 percent annual growth, or $4,140 each year if you can obtain 12 percent annual growth, to reach a million dollars at age 65. If you hold off until age 45 to launch your RRSP program, it will take $21,850 (at 8 percent) or $13,380 each year (at 12 percent) to accumulate a million.

- If the prospect of generating a million bucks in today's dollars sounds too daunting, make some adjustments. Do you really want to live in a large urban house when you retire? If your home is mortgage-free, you'll manage to keep virtually every penny of its value when you sell it, which helps tremendously to make up any shortfall between your RRSP value and that magic million! Your annual income needs will drop even lower by eliminating all the maintenance costs associated with your house.
- If you're married, and either you or your spouse earns substantially more income than the other, you can reduce the retirement income you'll need by cutting your income-tax level through a spousal RRSP, described in the upcoming section, "Spousal RRSPs and Income Splitting."

To calculate the amount you need to sock away to reach a million dollars, see Appendix A.

Paying Attention

If the biggest RRSP mistake made by most Canadians is failing to maximize their contribution each year, the second biggest mistake is not actively paying attention to the health of their investment. Like any growing thing, from carrots to kids, RRSPs thrive with attention, guidance, and general TLC. And who benefits? You do, with a larger nest egg to generate more retirement income.

Don't make the mistake of assuming your RRSP task ends with your annual contribution, or that your tax-refund cheque is the biggest benefit you enjoy. Paying attention to the growth of your RRSP, with a review every six months, can make an immense difference over the years. And you don't need a financial guru standing at your elbow, either. All it takes is a basic understanding of a few rules, a strategy you can follow, and a little advice now and then from a qualified adviser.

Spousal RRSPs and Income Splitting

If you are married or in a common-law relationship, it pays to understand spousal RRSPs and their benefits. The Canada Revenue Agency provides few breaks for married couples, but one pops up in the RRSP rules. It provides the option of contributing to a *spousal RRSP,* which not only generates the same benefits today but also delivers major reductions in income tax down the road.

A spousal RRSP permits you to place your RRSP contribution into a plan belonging to your partner. This cannot be used to increase your qualifying RRSP contribution limit; if your limit is $5,000 and you place it all in an RRSP belonging to your spouse, none is left over for your own plan in that year. So why bother? Because a spousal RRSP favours couples in which one spouse earns significantly more income than the other. If the high-income spouse contributes only to his or her RRSP, it will produce substantially more income when retirement day arrives *and* attract substantially more tax to be paid. Here's an example:

Jeff and Jean are the same age and have been married for 12 years. Jeff is a sales executive, and Jean is an artist. Each year, Jeff makes his maximum contribution to his RRSP — about $15,000 on average. Jeff and Jean feel this substantial investment is all they will need to build a hefty RRSP balance when they retire at age 55, and they are correct. If the plan is wisely invested and grows at a reasonable 10 percent annually, Jeff's RRSP will sport a healthy $900,000 balance by the time he is 55 years of age. They expect the $900,000 to produce at least 5 percent of its total value annually as retirement income, which means they will be earning — and paying tax on — a minimum $45,000 each year. But this entire amount will be earned in Jeff's name, and will be taxed accordingly. Using current income-tax rates, this will mean returning $14,465 to Ottawa every year as income tax, leaving them $30,535 as net income.

But if Jeff divides his annual $15,000 contribution into equal amounts, putting $7,500 in his RRSP and $7,500 into Jean's, they would still have the $900,000 nest egg, divided equally between the two plans, with each plan valued at $450,000 (assuming the same 10 percent average annual return for both plans). Instead of one income, the two plans generate separate incomes for each spouse, producing a different tax picture. The two separate incomes still total $45,000, but the total family income is taxed at $22,500 for Jeff and $22,500 for Jean. The lower figure triggers a lower tax rate; each spouse now pays about $6,000 in income tax each year, leaving them with a $33,000 net income — which will be like getting a $2,500 annual gift from the CRA. Over 20 years, that's $50,000 in income-tax payments Jeff and Jean will avoid.

There's more. Every Canadian with pension income can claim an annual $1,000 pension income tax credit. If both spouses earn income from their own RRSP, the couple can claim $2,000 total instead of $1,000 if only one partner has RRSP income. This move involves converting some RRSPs to RRIFs, because RRSPs alone cannot get pension tax credits. (For more about RRIFs, check out Chapter 5.)

Having a spousal RRSP may also help you avoid the Old Age Security (OAS) clawback, a voracious beast that starts consuming 15 cents out of every dollar earned above an annual retirement income level — for 2008 it's $63,511 — reducing your OAS payment to nil when your retirement income reaches the vicinity of $102,865. If your spouse is younger than 71 years old, and you expect to have earned income beyond age 71 — the age limit for making contributions to your own RRSP — you can contribute to your spouse's plan and still claim the tax deduction.

The CRA's definition of a spouse is "a person of the opposite sex to whom the individual is married or with whom the individual has cohabited in a conjugal relationship for a period of at least one year, or less than one year if the two individuals are the natural or adoptive parents of a child." Check with the CRA to confirm the definition if you are unsure of your situation.

Here are some things to know about a spousal RRSP:

- One more time: Having a spousal RRSP does not increase the total amount of the contribution you are allowed to make. If your limit is $5,000 and you place $4,000 in a spousal plan, this leaves only $1,000 for your plan.
- The money you contribute to your spouse's RRSP belongs to your spouse. But if he or she withdraws the funds from the spousal plan within three years, it is taxed as your income. For this reason alone, it is wise to keep your spouse's RRSP separate from his or her own plan, if one exists.
- If you and your spouse separate, the existence of a spousal plan will have no bearing on the division of assets if you reside in a province with family law provisions. Under these provisions, all shared assets accumulated during the relationship are divided equally — including both personal and spousal RRSPs.
- Income splitting to reduce taxes on your retirement income is a key benefit of a spousal RRSP. How big is the benefit? It depends on these factors:
    - The income-tax rate of the contributing spouse after retirement (If it's less than that of the owner of the spousal plan, no benefit is to be gained; you're simply dancing in circles, which may seem like fun but doesn't get you anywhere.)
    - The annual income generated from the spousal RRSP
    - The stability of the marriage (Spousal RRSPs are often called "prepaid alimony.")

Pledging Your RRSP as Collateral

The value of your RRSP represents an important asset to you, one you can expect to grow substantially with time. Banks, trust companies, credit unions, caisses populaires, and other organizations love folks with assets. In fact, people with money to lend favour people with assets so much they charge them a lower interest rate on borrowed money, as long as the loan is backed with *pledged assets,* or *collateral.*

So, can you pledge some or all of your RRSP as collateral for a loan and qualify for lower interest rates? And if you can — should you?

The Canada Revenue Agency says you can pledge some or all of your RRSP as collateral for a loan, but they do not encourage you to do it. If you pledge any or all of your RRSP assets as collateral, the fair market value of those assets held in your RRSP will be added to your taxable income for the year. If you assign $10,000 of your RRSP's value to a bank as collateral for a loan, the CRA acts as though you had withdrawn the same amount (or fair market value) in cash, and taxes you accordingly. When the loan is paid off and you no longer need the assets as collateral, you can deduct the amount previously included in your income minus any losses suffered over the term of the loan.

It's all very complex and fraught with danger — too much, in fact, to justify unless the reduced interest rate earned by using your RRSP is substantial. Besides, most financial institutions will not accept RRSP assets as collateral. They do, however, consider anyone with a good-sized RRSP balance to be a better-than-average credit risk, and adjust the interest rate charged on the loan downward to reflect this.

Here's one situation where it makes sense to use your RRSP assets as collateral, if you can find a financial institution to go along with it:

Suppose you find yourself suddenly unemployed for a short time. You may be tempted to withdraw money from your RRSP to cover essentials such as mortgage or rent, food, utilities, and so on. Unfortunately, when the funds are out of your RRSP, they cannot be put back in again when you find a new job. But if you borrow enough money to carry you over and pledge a portion of your RRSP as collateral, you can begin paying the loan back when you are employed again. When the loan is repaid, the pledge of your RRSP as collateral is lifted, you claim the deduction and any losses, and you haven't lost a thing.

This is probably the only time when using your RRSP this way makes sense. And only for a very short time.

Leaving the Country

What happens to your RRSP and all those tasty tax benefits if you leave Canada for employment in another country, such as the United States? It depends on where you go, and whether the move is considered temporary or permanent.

If you leave the country to accept temporary employment in the United States, you can continue to make RRSP contributions as long as you're still considered a Canadian resident under the Canada/U.S.A. tax treaty. Your employer or a tax accountant can provide the necessary documentation. If you commit to full residency and employment in the United States, and you pay income tax there, you can no longer make contributions to your plan. Nor, by the way, can you transfer its assets to an Individual Retirement Account (IRA), roughly the U.S. equivalent to an RRSP. You can, however, continue to maintain your RRSP in your absence, and its value will continue to grow free of Canadian tax. To escape U.S. tax on the growth of your RRSP assets, you need a special tax form obtainable from a qualified tax accountant.

What about cashing in your RRSP while living in the United States? Only if you're a glutton for tax punishment. First, Canada Revenue Agency will slap a 25 percent withholding tax on the proceeds. Then Uncle Sam will tax you on the entire value your RRSP earned between the day you left Canada and the day you closed your RRSP. You may even be subject to U.S. income tax as well.

Chapter 3

Your RRSP Strategy

In This Chapter

- Creating the right "recipe"
- Choosing investments for your RRSP goals
- Defining the most suitable choices
- Adjusting your program
- Measuring your progress
- Reading your RRSP statement
- Investing in your employer

A self-directed or customized RRSP will provide you with either a small sense of exhilaration — hey, you're in charge of your own future! — or a substantial dose of anxiety ("Hey, I'm in charge of my own future!").

The best way to make the most of it is by setting a strategy to maximize your RRSP growth over the years. Relax, you're not planning the D-Day invasion of Europe. You're just evaluating some basic facts, such as your age, the number of years remaining before you retire, the amount of annual contributions you'll be able to make, and the *risk threshold* that makes you comfortable while building the value of your RRSP.

Planning for your retirement income is like plotting a long journey. You start by deciding where you want to go and when you want to arrive there. Then you determine any stops you may need to make along the way, including a few to ensure you're still on the right course. That's really what an RRSP strategy is all about. Start with a goal (the total value of your RRSP when you retire); choose your route (the contributions and investments you'll make over the years); decide on some overnight stops (short-term goals); and schedule a pause now and then to confirm your progress (periodic investment reviews).

Of course, the RRSP journey for some people is a 30-year-plus excursion, which is not exactly a weekend trip to the cottage.

Investments Suitable for Your RRSP

Remember the three groups of investment types: liquid (cash and its equivalent), income (bonds, GICs, and mortgages), and growth (stocks and mutual funds). Almost any investment based on these characteristics is accepted by the Canada Revenue Agency for use in your RRSP.

Things you *cannot* hold in your RRSP (the CRA prevents it):

- Foreign cash (but you can have foreign Treasury bills, bonds, and equities)
- Collectible items such as coins, artwork, stamps, and antiques
- Mutual funds not registered with the Canada Revenue Agency
- Commodities, futures, and complex options
- Real estate (but you can have mortgages on real estate)
- Investments in small, privately held companies unless registered with a transfer agent

Things you *shouldn't* hold in your RRSP (common sense prevents it):

- **Annuities:** Annuities produce a steady income over a fixed period of time, purchased with a single large payment. They're a possible alternative to other options when you eventually retire, but they have no place inside an RRSP. Their tax-free growth status carries no benefit because everything in your RRSP grows free of immediate taxation anyway. What's more, annuities pay hefty commissions to the people who sell them, and they carry large administration fees. Avoid them. (For more on annuities, see Chapter 5.)
- **Limited partnerships:** Some investment salespeople may propose a limited partnership (LP) as a suitable RRSP investment. Some people may suggest removing your own appendix, too. For the record, an LP enables managing partners of a company or real estate development to use Other People's Money (in this case, yours) as capital. Later, when the term of the agreement is up, the investors and partners share in the profits.

  Sound like a good idea? It's not. LPs are sold through brokers and financial consultants who earn commissions as high as 10 percent, skimmed off the top of your initial investment. Management fees and other expenses are deducted from the operation each year, and the LP managers — who are paid by these fees and expenses — decide the amount to pay themselves. Sound bad? It gets worse. Unlike mutual funds, you can't vote with your dollars, because LPs are not liquid. Their term is usually from seven to ten years, and you cannot take your money out — whatever may be left of it — before the term is up. LPs have had a notoriously checkered history over the last two decades. If an adviser seriously proposes an LP for your RRSP investments, do two things: Say no . . . and look for a new financial adviser.

Matching Your Investment Mix to Your Goals

The ideal RRSP does not match the opinions or reflect the preferences of anyone. Instead, it meets the unique needs of its owner — that's you.

Your RRSP should change with time, just as you will. As you age, your priorities shift, you grow wiser in the ways of the world, and you tend to conserve your energy a little more. That's a good way to describe the changes you'll want to make to your RRSP over time. All of these changes, of course, will be influenced by your personal comfort level, your investment sophistication, and your risk threshold. That's what makes the ideal mix of liquid income and growth investments unique to you.

This section tackles your concerns, and the changes to your RRSP basic recipe you may want to make, decade by decade.

- **Up to age 25, you're fancy-free.** Retirement is an eon or two away, your income is limited, and your attentions are elsewhere. Still, this is the time when you can earn maximum rewards from every RRSP dollar you invest. This is the time to go for growth. You don't need income from your RRSP, and you don't need much liquidity. The vast majority of your investments should be growth-oriented, even if they are subject to wide fluctuations in value. For example, you may want to choose *sector funds,* which are mutual funds investing in specific industries, such as entertainment, communications, and health care or global regional mutual funds. These funds are subject to wild swings in value, but if the underlying quality is good, they are a route to maximum RRSP growth.
- **From age 25 to 35, you acquire commitments.** You may be married with children, have a mortgage, and be deeply involved in your career. You have more income, but more expenses as well. The needs of your RRSP reflect your new commitments, now geared for steady growth to maturity. Some of the riskier growth investments that appealed to you ten years ago aren't as attractive, and a little liquidity in your plan, enabling you to obtain cash if needed, wouldn't hurt at all.
- **From age 35 to 45, the word is reality.** You are approaching your maximum income level, and your RRSP contribution limits have risen accordingly. Most of all, your RRSP is now worth a fair amount of money — and that's good, because all those people who appear in advertisements promoting retirement benefits start looking like you and your friends. Your major concern is holding on to all the money your RRSP has earned over the years, and that means more income and security. You still need growth, but now you prefer sure and steady improvements rather than fast-paced, jerky motions — kind of like your changed taste in music.
- **From age 45 to 55, the horizon draws closer.** Perhaps you're an empty nester by now. In any case, you relish each increase in your RRSP's value

and look for all the guarantees you can get. It's a time of consolidation and preparation. Income investments are especially attractive, and GICs or government bonds you once sneered at for their low earnings now find a place in your plan. After all, they are guaranteed and predictable, which, you've come to learn, is something life is not.

- **From age 55 to 65, it's harvest time.** You focus on both "topping up" your RRSP before converting its assets to retirement income and locking in as much as is comfortable with reduced-risk investments. Growth and liquidity are still factors, but you're more conscious about holding on to what you have. During your 60s, build the RRSP portfolio suitable for your 70s. (See Chapter 5 for information about RRIFs.)

Keeping the three basic investment groups in mind — liquidable, income, and growth — the following sections examine the various options that deliver these qualities in various proportions. These are the raw ingredients of your recipe. Later, you can add a little spice if you like.

Savings accounts

You may have had one of these since you were a child. Besides being safe, they are also highly liquid, as you know if you ever took a hammer to your piggy bank. But money in your piggy bank tended to grow mouldy, and not much else. Savings accounts provide not much more than that these days, yet too many Canadians open an RRSP savings account, plunk their loonies into it, and call the whole process "retirement planning." It's not. Savings accounts do not pay as much as the rate of inflation, which means no growth and no income. A little liquidity in your RRSP goes a long way, but you can enjoy its advantages in better places than a savings account.

GICs

Along with savings accounts, guaranteed investment certificates (GICs) are one way for a bank, trust company, or credit union to borrow money from you. In return, GICs generate interest payable either when the GIC term — from six months to ten years — is up, or on a regular basis — monthly, semi-annually, or annually. These are known as *fixed-income* investments.

Some RRSP owners believe in GICs the way people believe in heaven: They're convinced nothing better exists. Sorry. Until you build substantial funds in your RRSP or approach retirement, many investment options are better for your RRSP than large quantities of GICs.

Bonds

A bond is basically a GIC with more class. Bonds pay higher interest, can be sold with relative ease (for high liquidity), and most come with a guarantee. They are admittedly more complicated than GICs. Essentially, a bond is an IOU issued by a corporation or a government in exchange for cold, hard cash they can use to expand business, pay debts, improve facilities, and for other practical reasons. It's worth getting to know them in detail. To do so, check out Chapter 6 in Book V.

T-bills

The *T* stands for treasury, which means your government needs a short-term loan to get it through the weekend. T-bills, bought and sold by investment dealers, pay rates comparable to guaranteed bonds. They are not intended for long-term investments, which makes them both highly secure and very liquid. You can obtain longer-term benefits from T-bills by investing in money market mutual funds trading in T-bills and selected high-quality bonds issued by large corporations.

For your safe, safe, safe money, resist the temptation to invest in strange stuff called "asset backed commercial paper," as so many investors did during 2007. These things are not as good as advertised. T-bills all the way!

Stocks

Here's where we enter sweaty-palm territory for investment novices. Too many Canadians associate the words *stock market* with the word *Crash!* That's because a slow and steady rise in the Toronto Stock Exchange (TSX) (which became TMX in 2008) and other stock markets never makes the front page of most newspapers, but a major drop in stock prices suddenly becomes big news.

The facts: Nothing provides better long-term growth prospects for your RRSP than a mix of shares in quality companies, in Canada and around the world. Choosing the companies in which to invest, however, demands knowledge, experience, patience, and a little luck now and then. The best advice when you're just starting your RRSP is, don't try this at home. That's what mutual funds are for (discussed in the next section.)

When you purchase a *common stock* (or shares) you own a piece of that company and are investing in its future prosperity. The price of the stock will fluctuate with the financial successes or setbacks of the company, influenced by

the economy and the sentiments of the market. Some companies, like some people, are more popular than others, even though they share similar characteristics with the less popular companies. Popular companies see their stock value rise and remain more immune to world events and the state of the economy.

Many companies issue two kinds of stock: *common shares* and *preferred shares.* They're a little like flying economy or first-class. Owners of preferred shares are first in line when dividends are handed out. (RRSPs rarely invest in preferred shares.) Owners of common shares have to wait until after the preferred shareholders have been paid their dividends.

Mutual funds

Suppose you had $25,000 in your RRSP, and you liked the idea of having someone manage it for you on a continuous basis. Every day, this manager would review your account before deciding which stocks, bonds, or other investments to buy and sell, based on the manager's knowledge, experience, and access to huge volumes of research information. In return, you would pay the manager about 2 percent of the value of your RRSP each year.

It's a nice idea, except that 2 percent of $25,000 won't get the job done. But if a thousand people like you pooled their RRSPs, the total would amount to $25 million, and 2 percent of that is $500,000 annually. Now you have a manager's attention — and, with a little tweaking here and there, you also have a *mutual fund.*

In reality, $25 million is a tiny mutual fund these days. Many Canadian mutual funds reach several billion dollars in *managed assets,* the money entrusted to them by investors. The skills of the fund manager should produce a substantially higher annual return for investors than they could earn on their own, more than making up for the annual fee paid to the manager. This is why the amount of money invested by Canadians in mutual funds exploded from a few hundred million dollars in 1980 to about $672 billion in February 2008.

Mutual funds provide the best opportunity for inexperienced investors to build their RRSP value over time. They also provide an excellent way to diversify your investments in several different ways. But they are not foolproof, and choosing the best fund for your needs takes some investigation by you, as well as some consultation with your financial adviser. (For more about mutual funds, see Chapters 1 and 2 of Book V.)

Mortgages — Yours and others

A mortgage is a legitimate investment for an RRSP, as long as it is secured by real estate within Canada — such as your own home, for example. Does this

mean you can use cash from your RRSP to finance the mortgage on your home and actually pay yourself with monthly mortgage payments? As a matter of fact, it does. Hey, why doesn't everybody do that? Here's why:

- It's a complex operation involving a mortgage trustee, real estate appraiser, legal counsel, and mortgage insurance. You need a specialist trust company to help you do this.
- It involves several high-priced people, all of whom expect to be paid, to set up the mortgage inside your RRSP. It also involves a separate self-directed RRSP fee each year.
- You need at least $50,000 in cash or liquid assets to make it worthwhile, and at least $75,000 to make it attractive.
- You cannot charge an excessive interest rate on the mortgage to build your RRSP. Canada Revenue Agency says the interest rate must be "comparable" to current rates in the marketplace. If your bank offers you a ten-year mortgage at 7.5-percent interest, that's the amount to set for your RRSP mortgage. You have some wiggle room, but not much.

Yet some advantages do exist. Mortgage rates are always a few percentage points above GICs, with similar security. And you can also use RRSP cash to fund a mortgage for someone else, including a son or daughter. But do you want to?

If your RRSP plans are just getting rolling, the mortgage option is not for you — at least, not for a few years. When the value of your RRSP hits six figures, you may want to review it, however. Most banks don't want you to borrow your own money to buy your own house because that's how the banks make their profit. If you do this move correctly, the bank's profit on your mortgage ends up in your RRSP.

Contributions in kind

Until now, the focus has been on making contributions in cash to your RRSP. But another alternative exists, called *contributions in kind.* A contribution in kind simply means transferring any eligible investment held outside your RRSP into your plan, where any earnings and growth it produces are subject to deferred taxation, just like other RRSP investments. If you own, inherit, or otherwise acquire some Canadian bonds (including Canada Savings Bonds, or CSBs), mutual funds, eligible mortgages, or shares in Canadian or foreign companies, you can move them into your RRSP and claim a deduction.

This is even better than it sounds. Suppose you've been purchasing Canada Savings Bonds over the years instead of contributing to your RRSP, and you have accumulated $5,000 worth of CSBs. Now you want to begin your RRSP, but don't have cash on hand to make a contribution. No problem. Launch

your RRSP with the CSBs as your opening contribution, and claim a $5,000 (plus accrued interest) deduction from your income for the year (assuming you have that much contribution limit, of course). If you're in the 40-percent tax bracket, this produces a $2,000 tax refund, and you have another $2,000 to add to your plan.

You can enjoy the same benefits if Uncle Herbie decides to give you a gift of his shares in Gold Brick Mining, Inc. Assuming they qualify as an RRSP investment, you can contribute them into your plan and earn a tax refund. The amount you can deduct is equal to the value of the shares, or any qualifying investment, on the day you transferred them into your RRSP.

Here's where things can get tricky. If Uncle Herbie paid $10 per share for the gold mine stock, and each share was selling for $20 on the day you transfer them into your RRSP, a light goes on at the Canada Revenue Agency. After all, the value of the shares has doubled since Herbie purchased them. That's a capital gain, and capital gains are taxable even though you have not sold the shares for a profit. Thus, Uncle Herbie will be assessed tax on the increase in the share value as soon as the shares are transferred to your name. The CRA calls this *deemed disposition.* If the shares also increase in value between the day they are transferred and the day you contribute them to your RRSP, this will be taxed as well. It's probably still wise to make the contribution this way; just be prepared for the tax it might trigger. (There's a bright side: Capital gains tax rates are substantially lower than others, so Uncle Herbie and you will enjoy a break if it applies.) Sadly, if Gold Brick Mining shares go down before being contributed to your RRSP, you cannot claim a capital loss.

You can even use your RRSP as a form of pawnbroker, in times of need. No, it won't loan you 20 bucks against your watch or wedding ring. But if you own eligible securities such as stocks, bonds, or mutual fund shares outside your RRSP, and you're strapped for cash on a fairly short-term basis, you can swap the securities into your RRSP and withdraw an equal amount in cash. Your securities continue to grow in value, but now the growth is tax-deferred. You have the cash you need to tide you over and, when the cash crisis is past, you can buy the securities back again. This is known as an RRSP swap and it gets a bit tricky, so you'll want professional assistance. But it can be done.

Overcontributing and Undercontributing

Some RRSP rules are set in concrete. Others kind of float on foam rubber. If you have the cash available, and if you enjoy shaking things up a little, this is one area where you can bend the rules to your benefit.

Putting too many eggs in your basket (or, you can never have too many eggs)

If you believe in taking every advantage offered you, consider again the benefit of contributing more to your RRSP than the Canada Revenue Agency officially allows.

As mentioned in Chapter 1, tax regulations allow you to exceed your contribution by up to $2,000 at any time up to retirement. This is cumulative, by the way, not an annual limit. When you retire, you adjust the balance of your RRSP by claiming the excess as part of your final RRSP contribution. If in your final year of making RRSP contributions your limit is $8,000, you must subtract any overcontribution from that amount to arrive at your actual maximum contribution limit.

The idea was to provide RRSP owners with a margin of error, so they could avoid the severe penalty of 1 percent per month on excessive RRSP contributions, which doesn't kick in until the $2,000 limit is exceeded.

Overcontributing to your RRSP has benefits. You'll have an extra $2,000 growing tax-sheltered within your plan for several years. If it grows at an average 10 percent annually, after 20 years your $2,000 will be worth about $15,000, which is $15,000 more than if you had strictly abided by the rules.

Drawbacks? Drawbacks always exist.

First, this assumes you are young enough to wait 20 years before collecting this particular bonus. Trouble is, people in their mid-30s are often too strapped for cash to even meet their maximum permitted annual contribution, so going $2,000 over it, even once, could be a stretch.

Next, use the $2,000 up and you have no margin for error. Every loonie you happen to contribute over your limit in the future brings with it a penalty of 1 percent per month.

Should you overcontribute? Sure, if the extra dollars are available and you're careful to monitor your contributions in the future, avoiding that nasty penalty.

Putting too few eggs in your basket

In contrast to excess contributions, most Canadians find they don't have enough funds on hand to reach their RRSP limit. This creates carry-forward

amounts, which appear on the CRA's Notice of Assessment sent to you after you file your income tax return.

Making up some of this unused contribution room is a good idea — but where can you find the money? Here are four possible sources:

- **Year-end bonuses:** If you receive year-end bonuses from your employer, as much as you want can be contributed directly to your RRSP tax-free, providing you have not reached your contribution limit.
- **Contributions in kind:** You can use RRSP-eligible investments held outside your plan, such as stocks, bonds, and mutual funds, to make up unused contribution room.
- **Your tax refund:** Roll it into your RRSP immediately to absorb at least some carry-forward and start building your plan balance.
- **Borrowed money:** Take out a loan as long as you can pay off the balance within 12 months (see Chapter 1).

Review Your Progress

The administrator of your regular or self-directed RRSP will issue statements either each month or each quarter. This is not junk mail — take a few moments to review each statement and file it away with others for reference. Here's what your statement will include, and what we suggest you take the time to review:

- **A summary of your account:** Look for any change in asset value (the total value of everything in your RRSP). Is your RRSP worth more or less than on your previous statement? If more, how much (if any) was generated by new contributions? If less, did you expect a drop due (almost exclusively) to fluctuations in the value of your investments?
- **A summary of your contributions:** The statement will include contribution activity both since your last statement and during the year to date. Look for confirmation that your contributions are being registered.
- **Plan growth:** Look for the increase in the value of your RRSP since placing it with the bank, trust company, investment firm, or other administrator.
- **Transactions:** Look for a record of all transactions in your RRSP since you received your last statement. This includes new contributions, any buying or selling of investments (bonds, mutual funds, and so on) held in your RRSP, and any rollover of GICs or T-bills that have matured since

your last statement. Did you authorize these trades or renewals? Do you understand why they were made?

- **Account valuation:** Look for both the *book value* (what you paid for them originally) and *current or market value* (what you would get for them if you sold them on the date of your statement) of all the individual assets held in your RRSP, including GICs, T-bills, bonds, mutual funds, and other investments. Which ones have risen since the last statement? Which ones have fallen in value? How comfortable are you with this?
- **Cash balance:** Look for excessive amounts of cash. A few hundred dollars is probably not worth being concerned about. If it approaches $1,000 or more, find better ways of earning money from it through the purchase of T-bills or money market funds, which are better than cash because they earn more interest. (Cash can build up in your account from various sources, including dividends from stocks you own in your RRSP, unallocated contributions, interest payments from bonds or mortgages, or other reasons.)

How to Read Your RRSP Statement

Each RRSP administrator has a slightly different statement format, but they all include certain key areas of information. Please remember that *your RRSP statement is not junk mail.* It is in your self-interest to review it briefly as soon as you receive it, and scan it in detail on a regular basis. File copies in a safe place. Figure 3-1 shows the first page of an actual RRSP statement from a bank-owned brokerage to one of its RRSP customers (we've changed the brokerage and customer's name, but not the figures).

Here are some points to note about the first page of the RRSP statement shown in Figure 3-1:

- It was not an especially good month for this RRSP investor, or for the market generally. The total value of her plan dropped by over $200. But she has a long way to go before retiring, and building her RRSP is not an unbroken straight line.
- Almost 90 percent of her RRSP is invested in fixed-income investments — in this case, government strip bonds. They're safe and secure, which helped avoid larger losses during any down-market period for equities. But at 42 years of age, she is much too young to have such a large portion in low-earning investments like these.

- No contributions were made to her RRSP during the first two months. She makes a lump-sum contribution near the end of each year. A series of 12 monthly contributions would be better, providing her with the advantages of dollar-cost averaging.
- The plan has just $5,047.13 in foreign content, representing 16.4 percent of the plan's total book value. This is too low. With her next contribution, the RRSP owner should either sell some of her strip bonds or begin expanding her foreign portion, perhaps with a conservative but often well-performing global equity fund.

ANYBANK CANADA, INC.

Registered Retirement Savings Plan
Statement of Account
September 2007
Currency: Canadian Dollars

This statement is for
September 1 to September 30, 2007

SUMMARY OF YOUR INVESTMENTS

	August 31, 2007	September 30, 2007	% Total Value
Cash & equivalents	$ 542.03	$ 543.11	1.3
Fixed Income	$ 37,288.66	$ 37,311.71	87.5
Equities	---	---	---
Mutual Funds	$ 5,062.00	$ 4,766.85	11.2
TOTAL	**$ 42,832.69**	**$ 42,621.67**	**100.0**

SUMMARY OF YOUR RRSP CONTRIBUTIONS

	First 60 days	Balance of the year	Total to date
Contributions made by you	0.00	0.00	0.00

SUMMARY OF YOUR FOREIGN CONTENT

	Book Value	% of current book value
Canadian investments	$ 25,656.65	83.6
Foreign investments	$ 5,047.13	16.4
Total book value	**$ 30,703.78**	**100.0**

Figure 3-1: The opening page of an RRSP statement includes account summary information.

Figure 3-2 breaks down the plan contents in detail. A few things to note:

ANYBANK CANADA, INC.

Registered Retirement Savings Plan
Statement of Account
September 2007
Currency: Canadian Dollars

This statement is for
September 1 to September 30, 2007

DETAILS OF YOUR INVESTMENTS – CANADIAN DOLLARS

Cash and cash equivalents		Book value	Value Sept. 30, 2007
CASH		$ 543.11	$ 543.11
Fixed Income	**Face value**	**Book value**	**Value Sept. 30, 2007**
CPN. GOV'T OF CANADA DUE DEC 01 2010	$ 15,000	$ 7,747.50	$ 11,080.50
CPN. NEWFOUNDLAND & LABRADOR HYDRO DUE DEC 15 2012	$ 11,860	$ 4,981.20	$ 7,514.02
CPN. NEWFOUNDLAND & LABRADOR HYDRO DUE JAN 14 2014	$ 29,707	$ 12,384.84	$ 18,717.19
Total fixed income	**$ 25,113.54**		**$ 37,311.71**

Mutual funds	Units	Book value($)	Unit Price($)	Value Sept. 30, 2007
SMOKY MOUNTAIN RESOURCES FUND	261.197	5,047.13	18.250	$4,766.85
Total Canadian dollar investments		**30,703.78**		**$42,621.67**

Figure 3-2: More specific account activity appears on page two of this RRSP statement.

- The government strip bonds are laddered.
- The bonds do not indicate their annual percentage yield. You have to figure that one out for yourself. The 2010 Government of Canada bond, for example, was purchased for $7,747.50 (book value); was worth $11,080.50 on September 30, 2007; and can be cashed for $15,000 on

December 1, 2010 (face value). In the years until its maturity date, the bond will earn just under $4,000.

- The Smoky Mountains Resources Fund slipped almost $300 in value since it was purchased. It's a long-term sector fund, not a core equity fund.

Remember, this is only a one-month snapshot of constantly changing market values. Assuming this RRSP owner was 15 to 20 years from retirement, what would you advise her to do?

- Sell the strip bonds and buy a broadly based foreign equity mutual fund?
- Sell the mutual fund at a loss and buy safer, more secure strip bonds?
- Sell some bonds and the mutual fund, and hold cash or T-bills for a while to ponder the next move?
- Change nothing now but invest the next RRSP contribution in blue-chip foreign companies or a mutual fund investing in companies located outside Canada?

Notice how it is always easier to make decisions about other people's money?

When It Makes Sense to Invest in Your Employer

Should you hold shares of the company you work for inside your RRSP? Some employers encourage this idea, but beware the possible consequences of investing too much in one place and not diversifying enough. Spending a large portion of your RRSP on shares in your employer's firm means you are relying on the company for income, benefits, and retirement funds. If the company has bad times, you could lose all three.

It makes sense to spend your RRSP contributions on shares of your employer's company under these conditions:

- You're totally confident the company is well-managed and maintains a strong market position. In other words, your company is a market leader and is virtually debt-free.
- The company offers you shares at a discounted price (at least 10 percent to make it worthwhile) and no commissions charged to buy those new shares.

- The company offers you a *share purchase plan,* where it matches your contribution — usually on a 50-percent basis. So, for every dollar you spend to buy shares for your RRSP, the company adds 50 cents.
- You limit the value of its shares to no more than 20 percent of the total value of your RRSP or whatever you are comfortable with given what you know.
- You are ambitious and to be seen avoiding the company's shares would be a career-limiting move.

Chapter 4

Withdrawing Money from Your RRSP

In This Chapter

- Withdrawing money from your RRSP
- Using your RESP for your child's education
- Using your RRSP for your education
- Using your RRSP to buy a house
- Retiring early

It may burrow its way into your mind gradually, or it may spring full-blown when you open your RRSP statement someday and realize you have more assets in your plan than you expected. The temptation may be to withdraw some funds now instead of waiting for retirement, or to borrow a few dollars — it's your money, after all — and arrange to pay it back later. You may even like the idea of using your RRSP assets as a mortgage on your home.

All of these options, and a few others as well, may present themselves. What do you do? The general answer is the same one you were told as a child: Resist temptation. If you've managed to do this without fail, you may not need this chapter. But if your hand slipped into the cookie jar from time to time, absorb the advice and guidelines carefully.

Why Your RRSP Is Not for a Rainy Day

The biggest risk as your RRSP builds is to think of it as an emergency stash, a lump of money you can use when there's not enough cash in the bank or room on your credit card. It's your money, after all, and no one will scold you for getting your hands on it years ahead of time. But if you do, you'll lose in three major ways.

Sharing your withdrawal with the CRA

Your first loss will be in withholding tax deducted even before you get your hands on the cash. This is just the beginning of the Canada Revenue Agency's penalty for being impatient. The entire amount you withdraw will be added to your taxable income for the year, and while the withholding tax will be credited, you will almost certainly pay even more at tax time according to your tax bracket (see Table 4-1).

Table 4-1 Withholding Tax Rates on RRSP Withdrawals

	Canada (Excluding Quebec)	*Quebec*
Up to $5,000	10%	21%
$5,001 to $15,000	20%	30%
$15,001 and up	30%	35%

If you withdraw $10,000 from your RRSP, you'll actually receive only $8,000, because 20 percent, or $2,000, is sent to the CRA to be credited on your income-tax return for the year. In Quebec, you'll pocket just $7,000, even though your RRSP is now $10,000 poorer.

If you must withdraw funds (and only in dire circumstances, remember), do so in amounts of $5,000 or less, a week or more apart, to reduce the immediate tax impact. It's as simple as that! If you withdraw $5,000 this week and $5,000 next week, you'll receive a net amount of $9,000; withdraw the $10,000 all at once and you'll receive a net of $8,000. (The CRA used to permit $5,000 withdrawals one day apart at the 10 percent rate but tightened the rules when too many people reduced the tax by taking advantage of the short 24-hour interval.)

Stunting your RRSP's growth

Your second loss is the potential tax-sheltered growth you would have enjoyed inside your RRSP. This can be enormous and, in time, will dwarf the immediate funds you obtain (see Table 4-2).

Table 4-2 Future Cost of Early RRSP Withdrawals (assuming annual compound returns of 10 percent)

Amount	*In 10 Years*	*In 20 Years*	*In 30 Years*
$1,000	$2,600	$6,730	$17,450
$5,000	$12,970	$33,640	$87,250
$10,000	$25,940	$67,280	$174,550

If you're currently 30 years from retirement, the $5,000 you withdraw for today's needs will reduce your RRSP's value by almost $90,000 when you're ready to use it. That's a hefty price to pay on top of the income tax assessed.

Squandering contribution limit: No double dipping

Finally, the third loss is the contribution limit in your RRSP. The $5,000 you withdraw today cannot be made up later. It was based on previous income levels, and no amount of future income or pleading to the CRA will return it.

Financial emergencies arise, of course. But unless and until every other alternative has been explored, it simply does not make sense to take funds out of your RRSP to meet them.

The added risk of spousal RRSP withdrawals

Withdrawing funds from a spousal RRSP is fraught with even more risk. Only the planholder is permitted to take money from a spousal RRSP, and the withdrawn funds will be taxed as the planholder's income only if no contributions have been made to the spousal plan within three years of the last contribution. Thus, if you contribute to your spouse's RRSP this year and he or she withdraws money from it any time during the next two years, Canada Revenue Agency taxes the money as though it went directly into your pocket. Exceptions to this rule are the following:

- The parties are living apart due to a breakdown in the relationship.
- The contributing spouse has died.
- Either spouse is a non-resident.

- The planholder transfers the money to purchase an annuity, which cannot be accessed for three years.
- The money is transferred to an RRIF.
- The money is transferred to a registered pension plan and not withdrawn for three years.

Combining RRSPs and RESPs

RRSPs have siblings, including RRIFs, or registered retirement income funds — more about them in Chapter 5 — and RESPs, or registered education savings plans. The objective of RESPs is to provide parents and grandparents with the opportunity to accumulate funds to cover the cost of higher education for their children and grandchildren. While RESP contributions cannot be deducted from taxable income the way RRSP contributions can, the money remains tax sheltered. To make up for the lack of tax deductions, the federal government grant adds an extra 20 percent of annual RESP contributions, to a maximum of $500 annually.

RESP rules

Keep these guidelines in mind as you merrily sock away dollars for your little one(s).

The previous $4,000 maximum annual RESP contribution per child was dropped in the federal budget of March 2007. Twenty percent of however much you contribute over a one-year period is matched by the federal government grant — to a maximum of $500 each year and $7,200 per child in total. A few more points to remember:

- A lifetime cap on the RESP's contributions exists, at $50,000 per child. The value of the RESP has no lifetime cap. And because the maximum life of the plan is 25 years, your pride and joy had better head off to school by then — or, better yet, get back and graduate so they can start paying you back.
- All RESP payments are recorded by the calendar year, unlike RRSP contributions, which offer a 60-day grace period.
- You can withdraw principal at any time without taxation. However, you may have to pay back a portion of the government grants you received.
- Interest paid on cash borrowed to contribute to an RESP is not tax deductible.

If your child doesn't go to Ivory Tower College, aside from transferring the funds to an RRSP, you can get your original capital contributions back, tax-free. And you can get the plan earnings back if the plan has been in place for at least ten years, with returned earnings taxable to you, the contributor. If you have a family RESP, your other children can use their siblings' money.

Here's where your RRSP comes in: If you open an RESP for your child and he or she decides not to pursue a higher education, you can transfer up to $50,000 from the RESP into your RRSP or a spousal RRSP. This can be done if

- The RESP has been in place for at least ten years
- The child has reached age 21 and will not be attending an institution of higher learning
- A contribution limit exists in the RRSP or spousal RRSP (if no contribution limit exists, the RESP funds are returned to the contributor, subject to income tax plus a 20 percent penalty)

This makes an RESP a very attractive prospect. Your contributions build tax-free, helped along by government grants, and if your pride and joy decides to become a street vendor instead of a doctor or lawyer, you can soothe your disappointment by bumping up the value of your RRSP.

The Lifelong Learning Plan and Your RRSP

Even if your kids decide not to pursue their education past high school, it doesn't mean you can't. In fact, the government's Lifelong Learning Plan enables you to finance an education for either you or your spouse with money from your RRSP without subjecting it to income tax or penalty. The maximum withdrawal permitted from each plan is $10,000 in any calendar year and $20,000 over a four-year period. Other rules include the following:

- You must be enrolled, on a full-time basis, in a qualifying educational program before March of the year following the withdrawal.
- A *qualifying educational program* is one at a university or college, or certain training programs of at least three months' duration and including at least ten hours of instruction or course work per week.
- The amounts withdrawn for this program are repayable to the RRSP in equal instalments over a ten-year period.
- The first payment is due either during the last year you were enrolled in the program or during the sixth year after you made your first withdrawal under this program, whichever is earliest.

The Home Buyers' Plan and Your RRSP

If you have built up funds in your RRSP and have yet to purchase your first home, here's another way to put the money to use before your retirement years. The Home Buyers' Plan (HBP) is a loan from your RRSP to you, free of tax and interest payments. To qualify, you or your spouse must not have owned a home and lived in it as your principal residence for five years prior to making the application.

Canada Revenue Agency counts "five years" this way, when it comes to the HBP: Take the four years preceding the year you withdraw the money, plus the period of the year you make your withdrawal, ending 31 days prior to the date you take the money out of your RRSP. Clear? Good.

The exception to the five-year rule applies where disabled family members are concerned. If you already own your own home, you can use the HBP to purchase a home that provides better accessibility for a disabled and dependent relative if he or she qualifies for the Disability Tax Credit.

You normally get one opportunity to use this plan. Here's how it works:

- The property you are purchasing must be in Canada and must not have been owned previously by you or your spouse.
- It must be occupied as your principal residence within one year of buying it.
- The home can be existing or brand-new.
- The home can be detached, semi-detached, a townhouse or condominium, a mobile home, an apartment, or a share in a co-op housing corporation where ownership is transferable.
- Both you and your spouse may borrow up to $20,000 each from your individual RRSPs.
- Funds contributed to your RRSP within 90 days of the loan cannot be withdrawn for this program. Thus, make a contribution to your RRSP on February 28 and it cannot be applied to the Home Buyers' Plan until June 1.
- Annual repayments to your RRSP must be made on or before December 31 of each year (but, as with RRSPs, any payment made within the first 60 days of the year can be credited to the previous year).
- Repayments begin in the second calendar year following the calendar year in which the withdrawal is made. (Repayments on loans made in the year 2008 must begin in 2010.)

- Annual repayments will be determined by dividing the amount borrowed by 15. Thus, a deduction of $20,000 from your RRSP under this plan will require annual repayments of $1,333.33.
- Repayments are kept separate from contributions and are not tax-deductible.
- Repayments are made to the financial institution administering your RRSP and must be accompanied by a special RRSP repayment form available from your bank, trust company, or whoever is holding your RRSP for you. This is to prevent the money from being credited as a regular, tax-deductible RRSP contribution.
- Repayments larger than the scheduled amount will reduce subsequent payments by a proportional amount.
- Miss an annual repayment and you're in deep doo-doo with the CRA. The missed repayment will be declared as taxable income for that year. And, as a second slap on the wrist, the money will be deemed a permanent withdrawal, which means you can never put it back in your RRSP. Yikes!

Does this make the HBP worthwhile? It will for many people. From its inception in 1992 to the end of 2007, about 720,000 Canadians had taken advantage of it. Should you?

Buying your first home is as much an emotional decision as an economic one, and no one can put a price on another person's emotional satisfaction. Unless you can sweet-talk a relative or friend into providing an interest-free loan to help you acquire your dream home, the Home Buyers' Plan is your only alternative. Just keep these serious drawbacks in mind before taking this step:

- When the money is out of your RRSP, it is not building through tax-free compounding growth. This inevitably reduces the value of your plan over time . . . by a significant amount.
- What happens if you find yourself unable to manage the repayments? You'll suffer that two-pronged penalty of both paying income tax on the missed repayment and not being allowed to return it to your RRSP. It probably means you won't be making any RRSP contributions either. Consider this: If you had difficulty raising money to purchase your home by other means, how will you be able to handle mortgage payments, maintenance, RRSP repayments, *and* RRSP contributions unless your income takes a major leap?
- Given the constant fluctuations in property values, don't count on the value of your home increasing over time, making up for lost growth in your RRSP as a result of taking out this loan.

All in all, the program has more drawbacks than benefits. But if you still feel the way to your dream home is through your RRSP, applications for the Home Buyers' Plan can be obtained from a Canada Revenue Agency office.

Bowing Out Early

It may hit you while reviewing an especially rewarding RRSP statement or while sitting in traffic on your way to work, breathing the fumes of the car ahead of you. You may get the idea while on vacation, or upon hearing of the early demise of an old friend or school chum.

Wherever and whenever it occurs, at some point around 50 or beyond, you'll ask yourself: "Why am I still working? Why don't I turn my RRSP assets into something that will produce an income, and leave the rat race?"

It's a question only you can answer, along with assistance from your spouse, family, and financial adviser or investment counsellor. But before you go that far, here are some items to review:

- Take stock of your entire financial situation. Review your debts (including mortgage) as well as your RRSP assets.
- Do you have any other retirement income from private pensions? Will it enable you to retire early? Will there be reduced benefits if you do?
- Will you be totally retired or do you plan to work part time? If so, how much will you earn? Is this realistic?
- Review the estimated percentage of current income you'll require (see Chapter 2).
- Consider carefully the benefits of holding off retirement for a year or more. At middle age, about half your RRSP assets should be in equities. If the stock market is currently at a low ebb, this could reduce your expected retirement income. It may turn around and boost your nest egg substantially by this time next year. If the markets are galloping along, the reward for delaying retirement could be substantial. For example, if your equities total $300,000 and the market returns 20 percent over the next year, that's a growth of $60,000 in this sector alone.
- Some investment counsellors suggest a fake "retirement trial" for a few weeks. You'll still be working, but try to live on only the amount of income you expect to have during retirement. (You can do this on paper, if you like.)

Retirement is no longer a 65-and-out proposition for most people. Careful long-term management of your RRSP provides you with options, and options create freedom.

Chapter 5

The Time Has Come to Cash In!

In This Chapter

- Facing the end of your employment career
- Understanding RRIFs
- Evaluating your options: Annuities, LIFs, and L-RIFs
- Measuring other income sources
- Making objective decisions about your retirement

After years of paying into your RRSP, you'll make a decision somewhere, sometime, to turn the tables on your plan so that it will begin paying you. These payments will form part of your retirement income.

Your decision to begin drawing benefits from your hard work and diligence will be based on economics and emotions. In all likelihood, the larger your RRSP balance, the smaller the emotional impact. Leaving your work career, after all, is a little like taking your first parachute jump: No matter how carefully you've planned, something can always go wrong.

The End of Your RRSP as You Know It

You can begin drawing income from your RRSP assets at any stage of your life. Some people choose to do this in their 50s, expecting CPP (Canada Pension Plan) benefits to (they hope) kick in as early as age 60, supplemented (they hope again) with OAS (Old Age Security) benefits at age 65. Others enjoy the luxury — or bear the necessity — of continuing to contribute to their RRSP well beyond traditional retirement age.

The life of your RRSP winds up at the end of the calendar year in which you turn 71. This, by the way, is a brick-wall deadline. If you don't make some arrangement to convert your RRSP into an income-producing investment by that date, the Canada Revenue Agency assumes you have deducted the entire amount as one lump sum and taxes you accordingly. If you think the income tax you pay on your annual salary is substantial, wait until you see the size of your tax bill on a lump-sum income that could total several hundred thousand dollars in one year. So ignore this date at your peril.

Until age 71, you can manage to be semi-retired, draw income from previous RRSP assets, and contribute to an RRSP — all at the same time, although it is a silly strategy. Income from a part-time job qualifies for RRSP contributions, which is one way to counter the risk of inflation.

Consider the following situation: You decide to retire at age 60, with RRSP assets that are able to generate about $20,000 income annually. Added to the pension you're entitled to, and taking early CPP benefits, you have about $44,000 in annual income. However, because you still have a few years to go before the age 71 cut-off, you may decide to continue working in a part-time capacity, start contributing to a new RRSP, and reap the benefits of your hard-earned $20,000 RRSP income.

Suppose you accept a part-time opportunity that pays $1,250 per month, or $15,000 annually. The work not only provides extra income (up to $59,000 annually — see Table 5-1), but also enables you to open a new RRSP, contributing almost $3,000 annually to it and taking a tax benefit as a result. You will be able to do this, if you choose, until you turn 71, potentially providing you with an extra $40,000 or so in new RRSP assets.

By accepting the job after the end of the calendar year in which you first begin drawing CPP benefits, you won't affect your government pension income. If you do both in the same calendar year, Ottawa taxes back the CPP payments; Ottawa permits you to both earn an income and keep all your CPP benefits beginning the calendar year *after* your first CPP benefit.

Table 5-1 Earning and Saving Your RRSP Assets

Source	*Amount*
Old RRSP income	$20,000
CPP	$6,000
Private pension	$18,000
Part-time work	$15,000
Total	$59,000

Moving from RRSP to RRIF

Whenever you choose to begin cashing in on your RRSP assets, you have complete freedom to do what you like. However, when your 72nd year arrives, you must convert your RRSPs to one or a combination of three alternatives: a lump-sum payment, an annuity, or a registered retirement income fund (RRIF).

For almost everyone, the first automatic choice will be an RRIF followed by maybe an annuity. Withdrawing your RRSP assets in a lump sum triggers income tax on the entire amount. There may be times when this makes sense to some people, but we can't think of any, unless the RRSP is tiny.

If you've been successful at managing your assets through a self-directed RRSP and still feel comfortable doing so, your best choice to produce retirement income will likely be a registered retirement income fund, or RRIF, which is similar in operation to an annuity and provides a better opportunity to generate more income. For example, you can build inflation protection into your RRIF through diversification and laddered GICs (guaranteed investment certificates) or the more superior ladder of strip government bonds.

Do you have private pension benefits or deferred profit-sharing plan assets from your working career? If they're not locked in, you can roll them into your RRSP assets when converting them to an RRIF, which gives you more investment clout with fewer administrative fees and headaches.

Three more pluses for RRIFs: They provide almost total flexibility, which will enable you to take advantage of certain economic conditions; and with careful management they can provide a tax-free rollover to your spouse's RRIF or a lump-sum estate for your beneficiaries. Furthermore, your entire RRSP portfolio can become your RRIF portfolio — the only thing that needs to change after your 71st birthday is your account number.

How an RRIF Works

The easiest way to grasp the concept of an RRIF is to consider it an RRSP in reverse. Over many years, you paid the RRSP. Now the RRIF pays you. You manage these two investment vehicles differently, but perhaps not as much so as you may expect. The biggest change is a shift in emphasis from growth to income, although you still need to pay attention to your plan's growth to counter the risk of inflation and avoid outliving your money. You may also need to have continued growth for a younger spouse who will inherit your portfolio.

Rules for RRIF withdrawals

In case you may want to leave all your RRIF assets inside the plan, building to Everest heights of value . . . well, you can't. You must withdraw a minimum amount (sometimes called a minimum annual payout, or MAP) from your RRIF each year, measured as a percentage of the assets in your plan at the end of the previous year. The amount varies with your age, as shown in Table 5-2.

Table 5-2 Minimum Withdrawals from RRIF by Age (percentage of assets)

Age	*Minimum*	*Age*	*Minimum*	*Age*	*Minimum*
71	7.38%	80	8.75%	89	12.71%
72	7.48%	81	8.99%	90	13.62%
73	7.59%	82	9.27%	91	14.73%
74	7.71%	83	9.58%	92	16.12%
75	7.85%	84	9.93%	93	17.92%
76	7.99%	85	10.33%	94	20.00%
77	8.15%	86	10.79%	95+	20.00%
78	8.33%	87	11.33%		
79	8.53%	88	11.96%		

Example: If your RRIF value is $400,000 at the end of the year in which you turn 71, you have to withdraw at least 7.38 percent of that amount, or $29,520. The financial institution managing your RRIF can arrange to make payments to you during the year according to your direction. (You can always take out more than the minimum amount, of course.) At the end of each year, if you have not withdrawn the minimum amount, a cheque will be issued to you making up the difference.

If your spouse is younger than you, you can base the minimum withdrawal amount on your spouse's age, leaving more of your RRIF assets tax-sheltered to continue building in value.

No income tax is withheld when withdrawing the annual minimum from your RRIF. Taxes are withheld, however, on amounts exceeding the minimum. Using the example above, if you withdrew $35,000 instead of the minimum $29,520, income tax would be applied to the $6,480 above your minimum at source (that is, withdrawn by the financial institution managing your RRIF and paid to the Canada Revenue Agency on your behalf). All RRIF income, of course, is subject to income tax, and a tax return must be filed.

Look for income, but keep your eye on growth

While you were building your RRSP assets, you could see the difference a few percentage points of annual returns made over time. When managing your

RRIF, the impact can be just as dramatic and, best of all, more immediate. If you can manage to boost the average annual returns from your RRIF from 4½ percent to 8 percent, as shown in Table 5-3, both your retirement account and your estate will be substantially wealthier. The withdrawal levels are the minimum annual amounts set by the Canada Revenue Agency.

Table 5-3 RRIF Returns by Age and Percentage Return

		4½ percent Return		*8 percent Return*	
Age	***Percentage***	***Fund***	***Withdrawal***	***Fund***	***Withdrawal***
65	4.00%	$300,000	$12,000	$300,000	$12,000
66	4.17%	$301,209	$12,550	$311,486	$12,979
67	4.35%	$301,909	$13,126	$322,870	$14,038
68	4.55%	$302,051	$13,730	$334,061	$15,185
69	4.76%	$301,581	$14,361	$344,951	$16,426
70	5.00%	$300,443	$15,022	$355,417	$17,771
71	7.38%	$298,577	$22,035	$365,318	$26,960
72	7.48%	$289,444	$21,650	$366,429	$27,409
73	7.59%	$289,294	$21,274	$367,160	$27,867
74	7.71%	$271,117	$20,903	$367,472	$28,332
75	7.85%	$261,908	$20,560	$367,324	$28,835

Launch your RRIF with $300,000, accept 4½ percent returns, make minimum annual withdrawals, and at age 71 you'll be required to take just over $22,000 from a balance of $300,000. Get an 8 percent annual return — from income plus growth — and at age 71 your minimum withdrawal will be almost $5,000 higher, *plus your RRIF will have increased in value by more than $67,000.* If you can achieve this level of growth with a reasonable degree of risk, why not?

During your working years, you probably looked for ways to raise your salary level from time to time. Improving your education, adding new work skills, and changing employers are the most common techniques used in search of a bigger paycheque. Why not maintain the same approach with your RRIF? The tactics are different, of course, and because your basic expenses are likely fixed, you don't need a constantly growing amount of money each year. But some careful planning and periodic reviews can put several thousand dollars in your pocket each year from the same nest egg.

These current economic times present a challenge to RRIF owners looking for more income. Inflation remains low, which is a good sign. But low inflation also means low interest rates, which makes it difficult to obtain high returns that are guaranteed from some RRIF assets. In early 2008, five-year interest rates from GIC-based RRIF investments fluttered around the 4.6 percent mark, while one-year GIC rates hovered a half-percentage lower. If you've managed to accumulate $200,000 in your RRIF, these interest-rate levels would produce an annual income of barely $9,000 before eating into your principal. At that level annuities begin to look pretty good, even with all their disadvantages.

If you want to increase your earnings from the RRIF above a paltry 4 percent annually, you'll have to accept some risk. But this is not an easy time in your life to accept risk. You need both solid financial advice and an awareness of your own risk-tolerance level. Fortunately, by now you've spent many years getting to know both, so some of these decisions may be a little easier to make than you think.

Looking at Other Options, Part 1: Annuities

A generation or so ago, back when many Canadians considered life insurance almost a basic requirement, annuities were very popular. Promoted and managed by insurance companies, annuities could be purchased with the funds built up inside *whole-life insurance plans.* Whole-life insurance, thanks to higher premiums, provided both immediate life insurance coverage and a cash-value pot of gold on your 65th birthday. (The alternative to whole-life insurance, known as *term insurance,* provides only a lump-sum payment to your beneficiary and no cash value when you reach 65. This inspired many insurance salespeople, who wanted to push whole-life insurance because it earned them higher commissions, to say, "With term insurance, the only way you win is by dying." As a result, most people chose whole-life and made a lot of insurance salespeople very wealthy.)

Part of the sales pitch used by insurance salespeople was that the money claimed by the policyholder at age 65 could be used to purchase an annuity from the same insurance company. An *annuity* is a contract that guarantees a series of payments in exchange for a lump-sum investment. The size of the payments depends on a number of factors, including the following:

- The amount of money used to purchase the investment
- The age of the person purchasing the annuity (the *annuitant*)
- The annuitant's gender
- The length of time the payments are guaranteed (anywhere from five years to the life span of the annuitant)

- Whether the annuitant chooses to continue the payments to his or her surviving spouse

In other words, you paid the insurance company while you worked, and the insurance company paid you after age 65. Or, to put it cynically: When you're paying insurance premiums, the insurance company is betting you will live; when you're collecting an annuity, the insurance company is betting you will die. Either way, money flows through the hands of the insurance company, providing it with many opportunities to make a profit.

Annuities began to fall out of favour around the same time Canadians realized term insurance came at a much lower premium price than whole-life insurance. They could invest the difference themselves and beat the insurance companies at their own game. Annuities continue to be popular with folks who prefer not to get their hands dirty and have their minds cluttered with investment decisions. They prefer to choose among various annuity options and settle down to a fixed income for the rest of their life. Market turbulence? Risk versus reward? Income versus growth? To an annuitant, those are all someone else's concern.

With an annuity, all your decisions are made upfront; the most critical is choosing whom to purchase the annuity from. Annuity payments fluctuate not only according to the firm providing the annuity, but also according to the date you purchase the annuity. The $100,000 you invest in an annuity this month could purchase more or less of an income for you next month. Whether you choose to wait, hoping the rates will rise, or buy now, fearing the rates will fall, *you are locked in for life.* That's one of the minus sides of annuities.

Annuities are calculated on the basis of the monthly income paid per $50,000 or $100,000 originally invested, and are influenced by various factors and options (see Table 5-4).

Table 5-4 Factors Influencing Annuity Payment Rates

Factor	*Payments Increased*	*Payments Reduced*
Age	Older	Younger
Gender	Male	Female
Guaranteed term	5 years	10 years (or longer)
Surviving spouse	Excluded	Included

Table 5-5 provides some idea of the range of annuity payments provided by major Canadian insurance companies for a male in good health as of May 2007. These rates change day to day, so don't expect them to be exactly on the mark when you read this. But if no major economic event has occurred between now and then, these rates may still be in the ballpark.

Table 5-5 Ten-Year Guaranteed Monthly Annuity Payments per $100,000 Invested, by Age of Annuitant (as of May 2007)

Male	*Age 55*	*Age 60*	*Age 65*	*Age 70*	*Age 75*
Canada Life	$538.72	$588.55	$648.37	$717.68	$795.07
Desjardins	$517.40	$565.87	$628.98	$706.69	$793.75
Empire Life	$501.97	$552.84	$619.58	$685.95	$758.75
Equitable Life	$519.33	$566.27	$627.43	$703.66	$790.82
Great-West Life	$534.71	$588.61	$645.48	$715.61	$793.93
Manulife	$505.65	$553.80	$616.05	$694.65	$779.07
Standard Life	$501.66	$547.70	$606.81	$679.58	$764.63
Sun Life	$508.57	$556.78	$620.17	$697.60	$783.76
Transamerica	$504.63	$552.80	$616.20	$694.17	$780.46

Source: Canadian Business, May 27, 2007

Using this payment schedule, a man aged 60 with RRSP assets of $400,000 could guarantee at least ten years of monthly income, before taxes, for as low as $2,190.80 (if he chose Standard Life) or for as high as $2,354.20 (if he chose Canada Life). Should he die before the guaranteed period expired, the payments would continue to his beneficiary to the end of the guaranteed period.

Based on the $400,000 original investment used to purchase the annuity, the Canada Life annuity would generate an annual income of $28,250.40, which equals an annual return of barely 7 percent. Five-year Canada bond rates at the time were yielding 4.43 percent annually, so this sounds attractive . . . until you remember that this form of annuity contains no protection against inflation, which could quickly erode the spending power. Annuities indexed to inflation are available, but they would generate substantially less income than the example shown here.

A couple of other points worth considering:

- That $28,250.40 annual income, guaranteed for ten years, means the insurance company is on the hook for only $282,500 if you croak before the ten-year guarantee is up. If the insurance company generates rates of 4.5 percent annual return from your $400,000, it will earn $180,000 over the same ten years, for a total of $580,000, yet is obligated to pay you less than $300,000. Is this a good deal for you? Perhaps, if peace of mind is your sole concern.

- Annuity payments aren't quite as volatile as the stock market, but they vary a surprising amount over relatively short periods of time. Transamerica Life, for example, paid 60-year-old males looking for a ten-year guarantee $607.32 per $100,000 per month in mid-1999. Eight years later, 60-year-old males were collecting almost $42 per month less for the same amount under the same conditions from the same company.
- Waive the ten-year guarantee, which means payments cease when you die, and you don't increase your income all that much. Canada Life, for example, will pay you only another $15 per month per $100,000. Should you die after receiving just one payment, the insurance company cleans up and probably throws a party in your honour. Big deal. Take the guarantee.

For comparison's sake, Table 5-6 presents annuity rates for females from the same companies and for the same guaranteed term, posted on the same day. Notice that the rates are slightly lower, reflecting the longer life expectancy of females.

Table 5-6 Ten-Year Guaranteed Monthly Annuity Payments per $100,000 Invested, by Age of Annuitant (as of May 2007)

Female	*Age 55*	*Age 60*	*Age 65*	*Age 70*	*Age 75*
Canada Life	$493.58	$533.72	$586.10	$650.55	$725.85
Desjardins	$483.82	$522.68	$574.54	$643.09	$730.25
Empire Life	$470.91	$511.06	$566.33	$631.24	$705.83
Equitable Life	$487.68	$526.66	$578.23	$646.07	$732.28
Great-West Life	$485.41	$529.77	$586.21	$647.81	$727.22
Manulife	$464.61	$503.78	$558.37	$626.30	$711.81
Standard Life	$473.72	$512.62	$564.34	$633.42	$720.75
Sun Life	$476.21	$520.00	$575.25	$644.06	$726.63
Transamerica	$468.23	$505.27	$557.66	$627.29	$715.25

Source: Canadian Business, May 27, 2007

Why such a wide range in annuity payments?

Approach two different insurance companies for their annuity rates, and you'll discover different levels of payments — sometimes a substantial difference (refer to Tables 5-5 and 5-6). What accounts for such a wide range? Three things:

- **Tables of mortality:** Insurance companies employ actuaries who spend their entire careers estimating how long people will live. Each company's actuaries can arrive at different estimates, and the company who decides you will live longest pays the smallest annuity.
- **Interest rates:** The money you use to purchase your annuity is invested by the insurance company. Wise investments generate bigger returns, which enable the insurance company to pay you a bigger annuity.
- **Guarantees:** The cost of annuity options you choose, including guaranteed terms and surviving-spouse payments, are priced differently by each insurance company according to the expected risk.

As you can see, to earn the most income from an annuity, it helps to be older (you won't be expected to live as long) and male (ditto), and to choose a shorter guaranteed term and payments that cease upon your death. Only payments due to you during the guaranteed term can be left to a beneficiary in the event of your death.

Should you choose an annuity for your retirement income?

Perhaps, if the following applies to you:

- You have relatively small retirement savings that must generate an income for a very long time because you are relatively young, your family has a history of living to a ripe old age, or both of these factors.
- You want the peace of mind that comes from knowing you will have a fixed amount of income.
- You prefer to avoid making any decisions when it comes to investing your money.

But be aware of these drawbacks:

- You lose control of your savings and the returns they can generate for you.
- Lump-sum withdrawals — to deal with a financial emergency, for example — are not permitted.
- The rate of return will be lower than the rates available from quality investments. If the stock market begins generating high annual returns, in the vicinity of 20 percent, and your annuity is returning only 6 or 7 percent, you'll just have to stand on the sidelines and watch.
- Unless you choose an indexed annuity, inflation could seriously erode your income over the years (but remember that indexed annuities also pay substantially less money to you each month).

- If you don't choose a guaranteed term or a surviving spouse option and you die shortly after the annuity begins (it happens more often than you may think), neither your beneficiaries nor your estate receive a penny.
- Choosing various options, such as guaranteed terms, payment to a surviving spouse, and so on, reduces your annuity income.
- Your annuity decision is locked in — literally for the rest of your life. So don't make it in haste, and be sure to discuss your decision with your spouse, your family, and your financial adviser before signing on the dotted line.

Looking at Other Options, Part II: LIFs and L-RIFs

If you're entitled to private pension benefits that are locked in (often referred to as a locked-in retirement account, or LIRA), you're faced with another decision. At one time, locked-in pensions that accrued during your working years provided no withdrawals; the total amount of your pension was used to purchase an annuity, with all the drawbacks reviewed earlier in this chapter.

Various provinces, beginning with Quebec, saw the unfairness of this restriction years ago and introduced legislation permitting locked-in pension benefits to be converted into a life income fund, or LIF. Think of a LIF as a locked-in RRIF. You determine how to invest and manage your LIF in the same way you handle your RRIF, and you must be 55 years of age before you can make any withdrawals. The same minimum payouts apply for LIFs and RRIFs, but a LIF adds a restriction to the maximum amount you can withdraw. This is to ensure that assets remain in the LIF when you turn 80 and you are required to use money left in your LIF to purchase a life annuity.

This is where things get complicated.

Unlike the fairly simplified formula for determining minimum withdrawals from an RRIF, the calculations for maximum withdrawals from a LIF in most provinces may remind you of high-school algebra:

Maximum LIF withdrawal = $B \times M \times F$

B is the *balance* in your LIF account on January 1 of the year you withdraw the money.

M is the number of *months* remaining until you turn 90.

F stands for *factor,* based on a combination of current long-term Canadian bond rates and 6 percent annual returns.

Alberta, Saskatchewan, Manitoba, and Ontario tweak the LIF idea with a locked-in retirement income fund, or L-RIF, which does not require you to purchase a life annuity at age 80. Each province sets its own withdrawal formula for L-RIFs. In Ontario, for example, L-RIF owners can simply withdraw the previous year's investment return from their L-RIF. This ensures that some assets from their L-RIF will remain in their estate when they die.

If you have a LIRA, consult with your financial adviser, investment counsellor, or the pension fund administrator for maximum withdrawal guidelines in your province.

Benefiting from Other Income Sources

Even after converting your RRSP assets into an income-producing plan, a number of other sources of money remain available to you. How you choose them and use them is up to you.

Your C/QPP benefits

When you turn 60, you are eligible for early C/QPP (Canada/Quebec Pension Plan) benefits. The formula sets full benefits at age 65, reducing them by one-half percent for each month under the threshold age. Thus, at age 60, you are entitled to 70 percent of full C/QPP benefits (5 years = 60 months × ½% = 30% subtracted from 100). Similarly, if you delay applying for C/QPP benefits past your 65th birthday, the benefits rise by one-half percent monthly.

Should you apply early? The consensus is a resounding "Yes!" for two reasons. First, if you wait until 65 to receive benefits, it takes a long time for the increased C/QPP payments to catch up with those lost five years. At current benefit rates, for example, you'll receive about $126,000 in total payments over the 20 years between age 60 and age 80. Wait until you're 65 to receive them and you'll be paid $134,000 over the 15 years between age 65 and age 80. Few people believe it's worth waiting five years to obtain a paltry $8,000 more in total benefits.

The second reason for applying early is the usual uncertainty about any government benefit. It may be withdrawn or seriously modified at any time. If you have been paying into it through all your working years, you are entitled to its benefits. Go get 'em. Just remember that your benefits won't begin appearing in your mailbox automatically when you turn 60 years of age. You must apply for them, preferably about six months in advance of your 60th birthday. Applications are available from your local office of Human Resources and Social Development Canada (HRSDC), or call 1-800-277-9914. Information is also available on HRSDC's Web site at `www.hrsdc.gc.ca`.

Your home

Along with the money built up in your RRSP/RRIF, your house represents a substantial asset. For many people, its value is at least as high emotionally as it is economically. If you have raised your family, with all the attendant pain and pleasures, under the same roof for a few decades, selling your home can be a wretched decision to make. Yet from a financial standpoint alone, your house, especially if it is mortgage-free, is both an underused asset and an ongoing expense. The equity in your home could be producing $5,000 annual income for each $100,000 of value, without depleting the principal by a penny.

Whether you choose to remain in the family home or choose another alternative is not a decision to be taken lightly, and it probably needn't be made right away either. So review all the following options, choose the one you're most comfortable with at the moment, discuss it at length with your partner and family, and give it a good deal of thought.

- **Stay where you are.**

  Pros: Comfort, security, no emotional stress, old friends and neighbours nearby.

  Cons: Maintenance costs, physical labour needed for upkeep, no active use of equity.

- **Stay where you are and generate income from a reverse mortgage.**

  Pros: Same as the preceding, plus active use of equity in home.

  Cons: Maintenance costs and upkeep continue; possibility of little or no estate value remaining. (Check out Chapter 4 in Book III for more information about reverse mortgages.)

- **Sell your current home and purchase a smaller home or condominium, perhaps in less expensive neighbourhood or community.**

  Pros: Reduce or eliminate maintenance and upkeep, opportunity for new friends and activities, some assets available for investment or income generation.

  Cons: Moving expenses, perhaps some emotional stress, distance from friends and family, possible loss of rewarding activities such as a garden and workshop.

- **Sell your current home and rent.**

  Pros: Eliminate maintenance and upkeep; all home equity is available for investment or income generation.

  Cons: Rental expense/drain on income.

- **Rent out your current home and move to an apartment or other facility.**

  Pros: Equity in home generates new source of income while maintaining asset value.

Cons: Maintenance, upkeep, tenant relationships, distance from family and friends as well as taxes to be paid on both rent collected and any capital gain on your former tax-free principal residence.

A Step-by-Step Approach to Making Decisions

Retirement is an emotional time, a mix of contrasting feelings ranging from anticipation and achievement to uncertainty and regret. The feelings you experience, and the way you deal with them, are yours alone. You may want, however, to impose some sort of structure on the decision making to assist your objectivity. Here are several things we recommend you do:

- **Take your time.** Unless it's the end of the year in which you turn 71, you don't need to rush into converting your RRSP into an RRIF or annuity. So give yourself some time to think things over. What are the priorities of your retirement? Will you travel a lot? Buy toys such as a new car, a boat, or a home workshop? Spend more time in your garden or performing volunteer work? Are you concerned about leaving a fat inheritance to your children or grandchildren, or to charity? You had goals during your employment years, and you'll set goals in retirement. It helps when making decisions about your RRSP assets.
- **If you don't need RRIF income right away, don't use it.** You may take a part-time job or have some private pension income or assets outside your RRSP to live on for a while. If that's the case, and you are still under 71 years of age, don't be in a rush to convert your RRSP to an RRIF. If you can leave it alone for a year or two, it will continue to build value sheltered from tax. Don't forget you can always withdraw money from an RRSP before it becomes an RRIF.
- **Consider splitting your C/QPP benefits.** This is an option available to couples where one spouse has a substantially larger income than the other. The spouse with the higher income can have up to 50 percent of his or her income transferred to the other spouse, reducing income-tax levels.
- **Set up a total review of your RRSP portfolio.** Do it sooner, rather than later. Call your financial adviser or investment counsellor and ask for a complete review of all your assets — RRSP, home equity, life insurance, private pension income, non-registered investments, the works. Give yourself at least an hour to discuss and evaluate them all. Include your spouse in the session. Then consider how each fits into your strategy.
- **Don't limit your investment horizon.** In your 60s and 70s, you could need a retirement income for another 20 years or more. That qualifies as a long-term investment horizon, which deserves the same kind of investment tactics you used when building your RRSP. So don't overlook equity investments, especially quality international growth-oriented

mutual funds, as a means of building your RRIF assets and a hedge against inflation.

- **You can still make investments — and should.** Past age 71, you can't enjoy the tax-sheltered advantages of an RRSP (unless you have "earned income" and a younger spouse), but that's no reason to avoid investing with available income if you have it. With two incomes, these investments should be made by the spouse with the lower income, to reduce income-tax levels.

Things to ask yourself before finalizing your RRIF investment mix

Are you planning any major changes to your lifestyle? Perhaps you're shopping for a vacation condominium, or you've come into a major inheritance. Or the change has been for the worse: You've lost your spouse, or your health has deteriorated substantially. How will any of these events affect your economic needs?

Have economic conditions changed? If inflation leaps out of the bushes and begins chewing up savings, currency exchange rates fluctuate a lot and eat into your foreign investment returns, or the stock market is riding either a severe bearish or wild bullish trend, this will influence your investment decisions.

Has your income tax status changed significantly? This is likely to be the result of assets held outside your RRIF. For example, if you sell your home and invest the proceeds, these earnings will be added to your RRIF income and could bump your marginal income tax to a higher bracket.

Are you worrying more about your investments? During your working years, it was easier to accept volatility and paper losses in your RRSP than it will be after you retire. When those same dollars are put to work earning you a living, their ups and downs are a little harder to deal with. If that's the case, perhaps you should exchange some growth and income in your RRIF for a little more security.

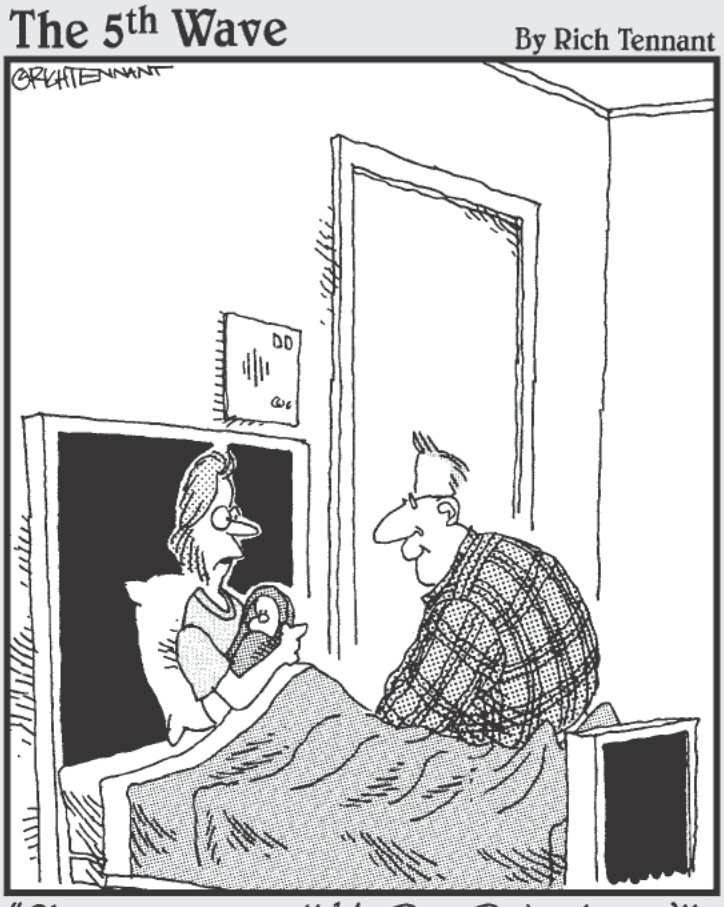
Have you maintained a balance in your RRIF investments? Paying attention to the relative size of equities and bonds in your RRSP has probably helped you maintain the balance that feels best for you. RRIF owners can become a little neglectful of this aspect, so check once a year to ensure that the balance between secure investments — GICs, bonds, T-bills — and equity investments matches your strategy and comfort level.

Do you still need the same rate of return? You may be delighted when you discover a portion of your RRIF is churning out 15 or 20 percent in average annual returns, but remember that this kind of growth usually involves risk and volatility. Are the returns worth it? Should you shift more emphasis to security?

Have your goals changed? Sitting on your back porch each day may have been fun for the first several months, but if you have an urge to see more of the world or to satisfy a craving for a sailboat, this puts new pressure on the performance of your RRIF investments. How badly do you want that new toy? How much pressure can you accept?

Will your RRIF need to outlive you? Your investment mix might need to be tuned for a younger surviving spouse.

Book VII
Estate Planning



Contents at a Glance

Chapter 1: Estate-Planning Basics 555

Chapter 2: The Taxman Cometh: Taxes and Your Estate 563

Chapter 3: Creating an Estate Plan 585

Chapter 4: Reading and Understanding a Will 617

Chapter 5: Power of Attorney and Your Living Will 633

Chapter 1

Estate-Planning Basics

In This Chapter

- Understanding what your estate is
- Knowing why you need an estate plan
- Understanding how to use estate-planning tools
- Knowing when to create an estate plan
- Getting professional help with estate planning

We'll put the good news about estate planning right upfront: *You* have an estate! You don't have to be a sports star or to have inherited old family money to have an estate or to need to do estate planning.

Now for the bad news about estate planning: It forces you to think about death — and not just in an abstract philosophical kind of way. It forces you to think about your own death. It also forces you to think about leaving family and friends behind, when they still need you to be there.

You're probably not going to enjoy the estate-planning process very much, but this chapter explains why to do it even though it's not a lot of fun. And after you've done it, you'll feel a kind of virtuous glow because you've taken important steps to make things easier for the people you care about when you die.

What Exactly Is Your Estate?

Before you start wondering why the butler and chauffeur didn't show up for work this morning, here's a little more detail about what your estate is.

Your estate is made up of everything you own. Makes sense so far, right? But in legal terms, your debts — everything you *owe* — are also part of your estate, because what you own must be used to pay off your debts when you die. (For a quick start at taking stock of your estate, see Chapter 1 in Book I, which discusses how you can take a financial snapshot of yourself.)

Everything you own (commonly referred to in financial and legal terms as your *assets*) includes the following:

- A home, cottage, or other piece of real estate
- A boat, a car, or other motor vehicles
- Any money you have in cash, bank accounts, or GICs
- Any investments you hold, such as shares, bonds, mutual funds, RRSPs, or RRIFs
- Your valuable personal belongings, such as computers, a home theatre system, jewellery, artwork, antiques, silver and fine china, or collectibles such as a complete set of Elvis Plays Las Vegas memorial plates
- Your other belongings that may have value only as part of your household, such as furniture, kitchen utensils, linens, and clothing
- Any business you run as a sole proprietor or partner

Everything you owe includes the following:

- A mortgage on your home or other real estate
- Personal loans that have not been paid off
- Business loans made to you personally (if you're a sole proprietor or partner, you and your business are one and the same)
- Unpaid credit card balances
- Other unpaid bills
- Unpaid income and property taxes

Also, some other things, while not technically part of your estate, need to be taken into account when you think about whom you have to look after and how much they'll need to keep going:

- **Life insurance:** If you have a life insurance policy, when you die either your estate or an individual (or individuals) you name as beneficiary, whichever option you have chosen, will receive the insurance proceeds.
- **Pension plans:** If you are a member of an employee pension plan, your spouse or a person you name as beneficiary may be entitled to receive a pension or a one-time payment after your death.
- **Government benefits:** Your spouse and/or children may be entitled to receive either a pension and/or a one-time payment from the Canada Pension Plan, Old Age Security, Veterans' Affairs, or provincial Workers' Compensation Board after your death.

Besides being what you own and owe, your estate is also a legal entity that comes into existence on your death — sort of like a ghostly lingering reminder of you. It has some of the same legal rights you had when you were alive, such as the right to enter into contracts and to sue and be sued. It also has some of the duties you had, the principal one being the duty to pay income tax. We discuss your estate's activities in various places in Book VII, so don't let the terminology throw you for a loop.

Why Do You Need to Do Estate Planning?

Notice that this section is not titled, "Do You Need to Do Estate Planning or Not?" You *do* need to do it, so don't argue. The main reasons why you need to plan your estate are to make sure that when you die:

- **You have done everything in your power to see that your family has enough money to manage without you.** It takes planning to set aside and invest money for your family (refer to Books IV and V, which discuss investing) and to make sure you have enough insurance.
- **Your property goes to the people *you* want to have it.** If you die without a valid will, a provincial government agency (often called the Office of the Public Guardian and Trustee) decides who gets your property based on rules set by provincial law, and it may well not go to the people you have in mind (see Chapter 3 for a discussion about beneficiaries).
- **A person *you* choose will look after your estate.** Without a valid will, there will be no executor named by you who will have the automatic right to look after your estate; instead, someone (usually a family member) will have to apply to the court to be appointed to look after it (see Chapter 3 for more about choosing an executor).
- **You have a say in who will look after your children.** If both you and the children's other parent die, a will is the best way to let your surviving family and the courts know whom you would like to care for the children (see Chapter 3 for more about taking care of your children and the important concept of guardianship).
- **Your debts can be paid with the least damage to your estate.** If you make no plan for payment of your debts, there may not be enough cash available to pay them. If you leave no will, the person appointed to look after your estate will have to sell some of your property to get the necessary cash, without any guidance from you about what to sell and what to keep in order to give to a particular family member or friend.

- **The capital gains taxes your estate has to pay will be as low as possible.** When you die your estate is taxed as though you had sold everything you owned just before you died, and without proper tax planning the bill can be exceedingly high (see Chapter 2).
- **The probate fees your estate has to pay will be as low as possible.** In almost all provinces, probate fees are calculated according to how much your estate is worth; with advance planning, you can reduce the value of your estate for probate purposes, and so reduce these fees.
- **The future of any business you own has been looked after.** You need to plan ahead, whether you want your business to carry on and who should look after it, or you want it to be sold and how much you want for it (see Chapter 3).

Here's a final, even more morbid, reason to plan your estate. As part of the process, you can let your family know what you'd like done with your body. (Oddly enough, your body is not part of your estate, unlike the other things that belonged to you when you were alive; it belongs to your executor or, if you have no executor, your closest relative.) You can make your wishes known about organ donation (yes or no) and funeral arrangements (plain oak casket or the King Tut special, burial or cremation, flowers or donations to a favourite charity), so your family members don't have to go through the stress of making choices they think you'd approve of. You may end up saving your family members from fighting.

What Tools Are Used in Estate Planning?

Uh oh, things are starting to sound technical here. So we're going to need "tools" to do this estate-planning business, are we? Like what? A level, to make sure all family members are treated equally? A shovel, to beat off the Canada Revenue Agency?

Actually, the tools here are a little less physical . . . although it's probably not a bad idea to keep that shovel handy. When you know what your estate consists of and what you want to give to whom, you can choose some estate-planning tools to help you do what you want.

The most commonly used estate-planning tools are the following:

- **A will:** A will is a written, signed, and witnessed document that states how you want your property to be given away after you die, and appoints an *executor* to look after your property and debts after your

death. You can find out more about wills, including how important it is to have a lawyer prepare yours, in Chapter 4.

- **Gifts given during your lifetime:** A gift is a transfer of all your rights over a piece of property. When you make a gift, you no longer have the right to hold on to the thing given or to sell it or to take it back from the person you gave it to or to leave it to another person in your will. Giving a valuable gift usually has tax consequences for the giver. "Tax consequences" is a fancy way of saying "tax payments."

- **Trusts:** A trust is another way to give property away during your lifetime. But instead of giving the property directly to the person you want to have the use of it (the *beneficiary*), you give the property to another person you choose (a *trustee*) to hold and look after for the use of the beneficiary. Why, you may be asking, would anyone want to do a weird thing like this? The main reason is to prevent the beneficiary from having total control of the property (for example, if the beneficiary is a child, or mentally disabled, or hopeless about business matters; or if you want one person to have use of the property in the short term but want a different person to become the owner of the property at a later date). Some compelling income tax benefits to setting up a trust exist. If you decide to set up a trust, you'll need a professional — an estates and trusts lawyer or a tax expert — to advise you and to do the paperwork.

- **Joint ownership of property during your lifetime:** Joint ownership while you're alive allows you to control who gets the jointly owned property when you die. You can own property jointly with another person (or with other people) in all provinces except Quebec. All sorts of property (real estate, bank accounts, mutual funds, or other investments) can be owned in this way. When you die, your share in the property will automatically pass to the surviving owner. It's not necessary to mention the property in your will in order to pass it on to the surviving joint owner. In fact, you can't deal with joint property by will even if you want to.

- **Life insurance:** Life insurance is a kind of bet you make with an insurance company. You're betting you'll die, and the life insurance company is betting you won't. If the life insurance company loses, it has to pay up on the bet — that is, the proceeds of the policy. A life insurance policy helps you ensure your family has enough money after you die to replace the income you'll no longer be around to earn, or to help them pay off taxes or other debts without using up your estate. The downside (apart from the fact that in order to win the bet you have to die)? Many insurance policies end when the insured reaches retirement age — in other words, just when your chance of winning starts to improve.

When Should You Make an Estate Plan?

Most people put off estate planning because they don't want to face the certainty of dying. Some people are even afraid that doing some estate planning makes them more likely to die. As a public service, we offer some scientific facts about estate planning and death. Statistics do indeed show that 100 percent of people who have planned their estate die. However, statistics also show that 100 percent of people who *haven't* planned their estate die. You can now rest assured no cause-and-effect relationship exists between estate planning and death. A cause-and-effect relationship does exist, however, between a lack of estate planning and wasted time, trouble, and aggravation for the people you care about.

Now that you know estate planning isn't going to kill you, you may be wondering about the best time to do it. Make an estate plan as soon as you have any significant property (and you care who's going to get it), or as soon as anyone becomes financially dependent on you, whichever happens first. You are legally able to make a will when you're quite young — as soon as the age of 18 (even younger in some limited circumstances). Don't assume estate planning is something to do when you're "old," because you don't have to be old to die; you just have to be alive. Anyway, if we waited until we were "old," none of us would ever do any estate planning: No matter how old we get, we don't think of ourselves as old. Old is what other people get.

Don't fall into the trap of thinking only rich people need a will. If you have a bank account, a vehicle, a significant other, or even a collection of comic books, a will is a very good idea.

Going through the estate-planning process once is not the end of the matter. Estate planning is a *continuing* process, because you have to change your estate plan as changes occur in the following areas:

- **In your personal life:** Review your estate plan if you marry. Have a look again when you have children, and as they grow up, leave home, and start to earn their own living. Think about changing your will if your spouse or partner dies, if you divorce, or even if you separate and meet someone new.
- **In your business life:** If you start a business, alone or with others, review your estate plan to make sure it deals with your business's debts, as well as with the decision of whether your business will fold or carry on under new management when you die.
- **In your executor's life:** You may need to change your will if the person you have named as your executor is no longer willing or able to take on those duties, or if you decide you need someone with more sophisticated business or investment skills. (Not to knock Cousin Joe — he's a good guy — but does he know a stock option from a distributor cap?)

- **In the value of your property:** If the value of the property you own goes way up or down in value, you may want to make changes to your estate plan to deal with the change in the taxes your estate will have to pay and with the debts your estate may have. You may also want to re-think how you've divided up your property in your will if you're trying to treat everyone equally.
- **In the law:** Between the time you plan your estate and the date you die, there will almost certainly be changes to tax law, family law, and estate law that may require changes to your estate plan. Keeping tabs on the law can be hard — unless you're an eagle-eyed lawyer — so have a lawyer review your estate plan every now and then.

Should You Get Professional Help?

Estate planning, including cookie-cutter, will-preparation kits, is dangerous territory for the do-it-yourselfer. The law in these areas is very complicated. Mistakes are all too easy to make.

If you make a mistake in preparing or signing your own will and power of attorney, your will and power of attorney may not do what you want them to do, or, even worse, they may be totally invalid. And don't even think about what will happen if you make a mistake in planning to reduce the taxes on your estate.

But naturally you're worried about the cost of professional help. Will you have anything left in your estate after you pay for it? Obviously, cost will be related to the amount of work you want done. If you have a large estate and need to make complex arrangements to reduce taxes, sure, it will be expensive. On the other hand, a will is a real bargain as far as legal services go. Most lawyers look on wills as "loss leaders." They hope the executor will ask them to do the legal work for the estate after you die, so they don't charge very much to do the will. And the very best lawyers even avoid wishing for your demise!

Lawyers are not the only professionals who can help you in planning your estate. Although a lawyer (or, in Quebec and British Columbia, a notary) with experience in will preparation should always be used to draft the actual legal documents and can usually give you much of the estate-planning advice you need, other professionals can also help in the financial, investment, and tax-saving part of the planning process. They include

- Qualified accountants
- Accredited financial planners

You may also be able to get advice from people or institutions you deal with while building or planning your estate, such as

- Insurance agents or brokers
- Trust companies or banks
- Investment advisers and mutual fund agents

Even with professional help, the more you know the better. That's where this book comes in handy, taking you through the process of estate planning and preparing a will and other documents so you can get the most out of your professional advisers.

Chapter 2

The Taxman Cometh: Taxes and Your Estate

In This Chapter

- Discovering how your estate will be taxed
- Discovering the tax strategies for estate planning
- Knowing what tax-avoidance strategies are available only after your death
- Pre-planning to pay your estate's tax bill

Canada doesn't have "death taxes" or "inheritance taxes" (yay!), but that doesn't mean no taxes are payable following a death (boo!). Taxes at death can be quite substantial, but with proper estate planning you can keep them to the minimum possible. Alas, before you can do any planning, you need to understand basic taxes. That's what this chapter is about.

Taxes on an Estate

When you die, you may be gone but you're not forgotten by the tax authorities. Under income tax law, your estate is born as a brand-new taxpayer that comes into existence on the date of your death.

Your estate (via your executor) has to file estate tax returns annually, starting from the year in which death occurred until the year in which the last property of the estate is given out to the beneficiaries. Filing has two purposes:

- To report income of the estate so that it can be taxed in the estate
- To give the Canada Revenue Agency (CRA) information about distributions of income from the estate to beneficiaries, so the secondary income can be taxed in the hands of the beneficiaries. Assets are inherited tax-free, but if the assets generate income then the beneficiaries must report that secondary income to the CRA.

Estates are taxed in much the same ways as individuals. So, you have to know something about how individuals are taxed before you can know how estates are taxed.

In Canada, individuals pay federal and provincial income tax on their *income* and on their *capital gains.* Examples of income are the following:

- Salary or wages
- Commissions
- Tips
- Rental payments received
- Interest payments received
- Dividends on shares
- Profits from an unincorporated business

Capital gains are profits from the disposition (such as a sale or a gift) of *capital property,* which is property with a long-term value, such as the following:

- Shares in a corporation
- Real estate (but not your principal residence, usually your home — see "Should You Put Your Money into Your Principal Residence?" in this chapter)
- Valuable art, jewellery, collectibles, or antiques

Income and capital gains are taxed differently. Income tax is calculated on the full amount of an individual's income. Capital gains tax is currently calculated on one-half of a capital gain. You also have a certain element of control over how bequests are taxed, depending on the nature, and designated recipient, of the bequest.

Understanding capital gains

Tax on capital gains, rather than tax on income, is usually the big thing people have to worry about when they're doing estate planning. A taxpayer can make a capital gain by disposing of capital property for more than it cost, or have a capital loss by disposing of capital property for less than it cost. (See the section "Capitalizing on capital losses" in this chapter to find out what you do with a capital loss.)

Calculating taxable capital gains

It's easiest to explain how to calculate a capital gain by starting with a sale of capital property. And in everyday life, most capital gains arise from a sale. The amount of a capital gain on a sale is calculated by looking at two things:

- **The cost of the capital property,** which is the purchase price plus other costs of acquiring the property (such as legal fees, commissions, licensing fees, the cost of borrowing money to buy the property, and the cost of improving the property). The cost of capital property, when all of these things are taken into account, is called the adjusted cost base.
- **The amount received on the sale of the capital property,** which is the selling price minus the cost of selling the property. The cost of selling includes such things as repairs, advertising, legal fees, and commissions. This sale amount, when everything is taken into account, is called the adjusted sale price.

A capital gain (or capital loss) is the difference between the adjusted sale price and the adjusted cost base. If the adjusted sale price is higher than the adjusted cost base, you have a capital gain. If it's lower, you have a capital loss.

Only a portion of any capital gain is taxable. That portion is added to your income and is taxed as part of your income at standard income tax rates. The portion has changed from time to time. Way way back, before 1972, capital gains weren't taxable at all. Then for many years one-half of a capital gain was taxable. Then, for a period, a lifetime $100,000 exemption existed to offset all or some portion of a capital gain. Following that, three-quarters of a capital gain had been taxable. But recently, the portion has fallen twice — first to two-thirds and then again to one-half. As of mid-2008, it stands at one-half, and will likely do so for some time because it's not an election platform item for any federal party. To sum it up, one-half of any capital gain is your taxable capital gain, and is added to your income.

(The calculation of the capital gain or loss is a bit more complicated if you used the property for business purposes and claimed *capital cost allowance* — that's depreciation, or a gradual loss in value — against the property. In that case, you'll need to talk to the CRA or get advice from an accountant.)

If it walks like a capital gain and it quacks like a capital gain . . .

Don't assume you have a capital gain only by selling something you have bought. You can also end up with a capital gain on capital property

- **That you didn't buy** — that is, it was given to you as a gift, or you inherited it, or you received it as part of an employment package (such as shares or stock options).
- **That you didn't sell** — that is, you gave it away to someone as a gift, or you moved it from an investment account into your RRSP.
- **That you own at the time you die** — Canadian tax law makes the peculiar assumption that immediately before you die you dispose of all your capital property (this is called a *deemed disposition*).

When you become the owner of property in a way other than buying it, tax law says you acquired the property for its *fair market value* (the going price in the open market) on the day the property came into your possession.

When you give away capital property, tax law says you are disposing of the property at fair market value. Even though you're not actually getting a cent for your property, you're triggering a capital gain (or loss) that has to be reported in your income tax return for the year. And when that happens, you — or your estate, if you're dead — have to come up with cash to pay the tax on the capital gain.

If you trigger a capital gain on property you didn't buy in the first place or sell in the second place, how the heck are you supposed to figure out what the capital gain is? Well, you have to find out what the fair market value of the property was when you got it and when you disposed of it. This is easy with publicly traded stocks, for example, because an investment adviser can tell you what a stock was worth on any given day. But suppose you inherited a cottage from your parents and then gave it to one of your children. With property such as real estate, art, or jewellery, you'd have to get an expert's appraisal of the value at the time of acquisition and/or disposal.

And now for a strange tax fact: If you've owned property for many years (a family cottage or shares in a corporation, for example), for capital gains purposes you're responsible for the increase in value of the property only since December 31, 1971, referred to by the CRA as "V-Day." (V is for valuation, *not* victory over the CRA.) That's because capital gains were not taxable in Canada before that date. As a result of this change, owners of capital property don't have to go back any farther than that when they're figuring out the adjusted cost base of their property.

Capital gains tax and spouses

A taxpayer ordinarily has to pay capital gains tax whether the property is sold or given away, or "deemed" (by the CRA) to have been disposed of, if the capital property has gone up in value. However, an exception exists when a taxpayer transfers property to his or her spouse. No capital gain is triggered.

Common-law partners, for tax purposes, are deemed by the CRA to be two people who live together in a *conjugal* (marriage-like) relationship and have done so continuously for at least 12 months. They don't have to be married to each other, and have the same rights as married couples. The two people can be of the same sex.

When a taxpayer transfers property to a spouse, the spouse automatically steps into the shoes of the taxpayer and gets the original adjusted cost base

of the capital property along with the property. It is as though the spouse acquired the property at the same time and for the same price as the taxpayer did. This is called a *spousal rollover.* (Isn't this a great name? Unfortunately, that's as far as the income tax people went, and no spousal heel or spousal stay or spousal sit-up-and-beg exists in tax law.)

An automatic rollover — of the property, you understand, not of the spouse — occurs any time a taxpayer transfers property to a spouse during the marriage (or marriage-like relationship). When the spouse ultimately sells the property, he or she includes one-half of any capital gain, calculated using the *original* adjusted cost base, in his or her income. (The CRA can *attribute* the capital gain back to the spouse who originally owned the property; in other words, make that spouse pay the capital gains tax.) A taxpayer who doesn't think this whole idea of rollovers sounds like a heck of a lot of fun can choose not to have one.

Capitalizing on capital losses

Are you thinking how much fun it would be to take out the garbage just about now or clean the cabinet under the bathroom sink? You can't leave yet. Your torment is only beginning. This section tells you about capital losses. To remind you, a taxpayer has a capital loss by disposing of capital property for less than it cost.

Question: You have to pay tax on one-half of a capital gain — but what do you do with a capital loss?

Answer: If you have a capital loss in the same year you have a capital gain, you can deduct the capital loss from the capital gain before calculating your taxable capital gain. If your capital loss is more than your capital gain, you have taxable capital gains of zero in that year. However, you can use a capital loss to reduce only *a capital gain* in that year; you can't use a capital loss to reduce *income* in that year. What you can do is carry any extra capital loss back to any of the preceding three years to reduce taxable capital gains you had earlier. You have to file a new return to get back tax you paid in the preceding year or years. If you still have any unused capital losses, you can carry them forward indefinitely.

Now here's an amazing thing. Canadian tax law actually gives you a reason to die (other than the ordinary ones of sheer annoyance or apoplexy) if you have capital losses larger than your capital gains. In your very last income tax return, which is filed after you're dead, capital losses can be used to reduce income!

Special rules apply to capital losses in your last or *terminal* return. That's the return filed by your executor for the tax year in which you die. (There may be other returns as well for things such as intangible assets and trusts, but these are special things a professional accountant or estate lawyer can help you with.) In the terminal return, capital losses must first be used to reduce capital gains, but if any losses are left over they can be used first to reduce your other income in the taxation year in which you die, and then to reduce your other income in the taxation year *before* the year you die.

This gives you a whole new perspective on your inexorably approaching death, doesn't it?

Taking in taxable income

This tax primer has concentrated on calculation of capital gains so far because it's the most important stuff to know about if you're estate planning. However, the rules about calculation of taxable income have a bearing on RRSPs (registered retirement savings plans) and RRIFs (registered retirement investment funds) if they're a part of your estate, so we discuss a bit about income in this section.

Calculating taxable income

In the annual tax return, a taxpayer is required to list his or her income from all sources, including employment income or income from an unincorporated business, pension income, amounts withdrawn from an RRSP or RRIF, benefits from various sources, investment income, and rental income. These different types of income are added together to arrive at the taxpayer's total income.

Taxpayers are allowed certain deductions from their total income to arrive at their taxable income, the income on which federal and provincial income tax is calculated. Allowable deductions include the following:

- RRSP contributions
- Annual union or professional dues
- Attendant care expenses that allowed the taxpayer to earn income
- Certain child care expenses

Understanding tax brackets

Individual taxpayers don't pay tax on their taxable income at one single rate. Instead, they can pay tax at up to four different rates. As income increases, the percentage rate at which it is taxed also increases in steps, or by *brackets*.

It's hard to generalize about the combined rate of federal and provincial tax, because provincial tax rates vary from province to province, and both federal and provincial rates change from time to time. At the same time, some provincial tax rates are changing too. Roughly speaking, as of 2006, the tax brackets are as follows:

- If your taxable income is up to approximately $36,000, you'll pay tax at a combined rate of about 24 percent. However, the basic personal exemption tax credit reduces the tax payable on approximately $9,000 of this amount to $0.
- If your taxable income is between approximately $36,000 and approximately $73,000, you'll pay tax at a rate of about 24 percent on taxable income up to $36,000 and at a rate of about 32 percent on taxable income between $36,000 and $73,000.
- If your taxable income is between approximately $73,000 and $118,000, you'll pay tax at a rate of about 24 percent on taxable income up to $36,000, at a rate of about 32 percent on taxable income between $36,000 and $73,000, and at a rate of about 37 percent on taxable income between $73,000 and $118,000.
- If your taxable income is over approximately $118,000, you'll pay tax at a rate of about 24 percent on taxable income up to $36,000, at a rate of about 32 percent on taxable income between $36,000 and $73,000, at a rate of about 37 percent on taxable income between $73,000 and $118,000, and at a rate of about 45 percent on taxable income over $118,000.

Keep in mind these are very rough estimates. So don't trust us — check the combined federal/provincial rate in your province.

Should You Leave Everything to Your Spouse?

In order to make use of this strategy, you first have to have a spouse. (See "Capital gains tax and spouses" earlier in this chapter for how the CRA defines "spouse.") But don't put tax avoidance above your own personal happiness — don't acquire a spouse just so you can minimize estate taxes. If you do, you may be found floating face-down in the bathtub some day, while your spouse is seen elsewhere drinking champagne and waving around your life insurance policy.

If you already have a spouse, you may want to leave everything to him or her anyway, no matter what the tax consequences are. On the other hand, you may be thinking about leaving some or all of your estate to your children, grandchildren, or others. So this section looks into the pros and cons of leaving property to your spouse.

Dealing with capital property

Your capital property is subject to capital gains tax. Capital property, as explained earlier in this chapter, is property with long-term value, and you are deemed by the CRA to have sold all of your capital property for its fair market value just before you die (a *deemed disposition*). If what you owned went up in value after you got it, your estate will have a capital gain, one-half of which is taxable.

This rule about your capital property does not apply to any property you leave to your spouse in your will. The gift of the property in your will is not treated as a disposition of the property at its current value. Instead, an automatic spousal rollover occurs, and the gift is treated as a disposition of the property at its original cost to you. (If you've already forgotten what spousal rollovers are, you can refresh your memory in the "Capital gains tax and spouses" section in this chapter.) When you dispose of your property for the same price at which you bought it, no capital gain applies. So because of the spousal rollover, your estate will not have to pay any capital gains tax on the transfer.

But when your spouse decides to sell the property, or when your spouse dies, he or she is taxed on the increase in the value of the property from the time you got the property, not from the time *he or she* got the property.

If you leave all your property to your spouse, your estate will not have to pay any capital gains tax at all. But what if you don't want to leave everything to your spouse? What if you want to leave something to your children? Can the spousal rollover help you? Yes. You can still take advantage of the spousal rollover by leaving property that is subject to capital gains tax to your spouse while leaving property that is not subject to capital gains tax to your children or others.

The spousal rollover applies when you leave your property directly to your spouse. It will also apply if you leave your property in trust for your spouse in your will if the will is drafted so that your spouse has the right to receive all of the income earned by the trust for the rest of his or her life, and no one but your spouse has the right to receive any of the income or the property of the trust as long as your spouse is alive.

Distributing RRSPs and RRIFs

An RRSP (registered retirement savings plan) contribution is fully deductible from the taxpayer's income. You don't pay any income tax on money you earn that you put into an RRSP. So if you have income in a particular year of $40,000, and you make an RRSP contribution of $3,000 in that year, your income is reduced like magic to $37,000 for that year. Whenever you withdraw money from your RRSP, it's taxed as income in the year of withdrawal.

So if you have income in a particular year of $40,000 and you withdraw $3,000 from your RRSP, your income is increased to $43,000 for that year. When you reach age 71 (actually, you get to the end of the year), you have to withdraw everything from your RRSP, but you can roll it over into an RRIF (registered retirement investment fund) so you don't have to pay tax on the amount in the RRSP. You then have to make annual withdrawals from your RRIF and pay tax on those withdrawals as income.

Death of a taxpayer

A taxpayer who dies is deemed by the CRA to have cashed in all RRSPs (and also RRIFs) before dying, and the full amount of the RRSPs or RRIFs must be added to income in the terminal return.

Now here's the first twist. For estate-planning purposes, an RRSP or RRIF is not treated simply as cash in the estate if it's given as a gift in your will or it's directed to someone you've named as beneficiary of your RRSP or RRIF. When tax has to be paid on the RRSP or RRIF amounts that are added to income, the tax doesn't come straight out of the RRSP or RRIF. The tax comes first out of ordinary cash in your estate. So what can happen when you give someone your RRSP or RRIF is that the person gets the full amount of money in the RRSP or RRIF, but anyone who was supposed to get cash from your estate gets less because it's being used to pay the tax on the RRSP or RRIF.

Now for the second twist. If you make your spouse the beneficiary of your RRSP or RRIF and the proceeds are paid into your spouse's RRSP or RRIF, the money in the RRSP or RRIF is not added to your estate's income and no tax will be payable by your estate or by your spouse. (And your spouse will still have the right to make his or her usual RRSP contribution if they're not yet 71 years old.) If you name your estate as beneficiary of your RRSP or RRIF and your spouse is the beneficiary of your estate, the money in your RRSP or RRIF will be taxed in the hands of your spouse and no tax will be payable by your estate as long as your spouse and your executor file a *refund of premium* form with the CRA. Your spouse will have the right to avoid paying tax on the proceeds by depositing the RRSP or RRIF proceeds into his or her RRSP or RRIF. (Again, your spouse will still have the right to make his or her usual RRSP contribution.)

Likewise, if you name a child or grandchild who is financially dependent on you as a beneficiary of your RRSP or RRIF, or you leave the RRSP or RRIF to him or her in your will, your estate will not have to pay any tax as long as the beneficiary and your executor file a refund of premium form. The full amount of the RRSP or RRIF will be taxed as income in the hands of your child or grandchild. (The way in which the amount will be taxed depends on whether your child or grandchild is under the age of 18 and/or suffers a physical or mental disability.)

As you keep seeing, life — or death — is simple if you want to leave everything to your spouse. Your estate will not have to pay any tax. But suppose you don't want to leave everything to your spouse? You may have good and valid reasons; it's no one's business but yours. Anyway, suppose you'd like to leave something to your children or even to a friend? You can use your knowledge about how RRSPs and RRIFs are taxed to make sure both your spouse and someone else of your choice will get the most out of your estate while the CRA gets the least.

What's the best way to pass on your RRSP or RRIF?

If you want your spouse to get the money from your RRSP or RRIF, it's usually better to make him or her the beneficiary of the plan rather than having the plan go through your will because

- Your spouse will be able to get the money more quickly if he or she is named as the beneficiary.
- Your estate's probate fees will be lower (we discuss probate fees later in this chapter).
- The money will not be used to pay the debts of your estate.

If you want someone other than your spouse to get the money from your RRSP or RRIF, it's usually not a good idea to name that person as beneficiary of the plan. Leaving the RRSP or RRIF directly to that person in your will isn't a good idea, either. Instead, name your estate as beneficiary of your RRSP or RRIF and simply divide your estate among the people you choose.

Should You Put Your Money into Your Principal Residence?

Just to recap — so this concept is etched permanently into your brain no matter how much you'd like to forget it — when you dispose of capital property at a profit, you trigger a capital gain, and capital gains tax becomes payable. A home, cottage, or vacation property is a form of capital property. As with all other kinds of capital property, when you die you will be deemed

to have sold the property the day before you die. If the property went up in value after you got it, there will be a capital gain.

Now with most capital property, one-half of that capital gain would be taxable. But if this home or cottage or vacation property is your principal residence, your estate won't have to pay any capital gains tax.

What is a principal residence?

Here again is yet another incredibly boring definition that will lead you to a tax secret. A principal residence can be any residential property you inhabit or your spouse or your child ordinarily inhabits during the year. It does not have to be your main residence. Your cottage or vacation home can qualify as a principal residence as long as you occupy (or your spouse or at least one of your children occupies) the property for some time during the year.

The catch here is that, since 1982, a family is allowed only one principal residence each year. If you own only a house or only a cottage, the one property you own will be your principal residence. But what if you own both a house and a cottage? In that case, when you sell or give away the property — or die, more to the point — you (or your executor) must choose one of them to be your principal residence and to qualify for the capital gains exemption.

But can you make use of the principal residence exemption?

Because of the principal residence exemption, you can leave your principal residence to anyone you choose without worrying about your estate (or anyone else) having to pay capital gains tax on it. Whoopee!

If your only objective in planning your estate is to keep your taxes to a minimum, and if you've carefully followed and understood everything you've read in this chapter about taxes and your estate, you're thinking right now that you'll leave your principal residence to your children and leave your spouse some other property that's subject to capital gains tax. Great plan — start the engines and see if it will fly.

If you have only one residence

If you have only one property that qualifies for the principal residence exemption, and that property is your family home, you probably want to leave the property to your spouse, not to your kids. If you do that, an automatic spousal rollover already keeps your estate from having to pay capital gains tax, so the principal residence exemption doesn't add anything extra here.

And if you and your spouse own your family home as joint tenants (as most couples do), you can't leave your home to your kids even if you want to. That's because when you die, your share of the home will automatically pass to your spouse, no matter what your will says. Your share of the home will not become part of your estate.

All in all, you won't be able to make much use of the principal residence exemption if you own only one residential property.

If you have two residences

The principal residence exemption can be very useful, however, if you own more than one residential property. If you own a home and a cottage, for example, you can take advantage of the principal residence exemption to leave your home to your spouse and your cottage to your children. Your estate will not have to pay any capital gains tax on your home because of the spousal rollover. Your estate will not have to pay any capital gains tax on the cottage if your executor names your cottage as your principal residence.

Simplicity is a relative concept as far as taxes are concerned, but things are fairly simple if you never use your principal residence exemption from capital gains tax until you die. However, things will work out very differently if you have used your principal residence exemption in the past. That's because you can have only one principal residence in any given year.

Should You Give Things Away Now?

You may want to give things away to others before you die for any number of reasons. You may

- Take pleasure in watching them enjoy your gifts while you're still alive. Conversely, you may take sadistic pleasure in watching some of your friends and relations seethe because you gave gifts to others and nothing to them.
- Own property that is too expensive or too much trouble for you to keep up any more.
- Hope to keep your family from fighting over how to divide your estate after you die.
- Hope to save taxes either for yourself now or for your estate later.

If you're dead set on giving away your property while you're still alive, you can do it in a couple of ways. You can make an absolute gift of the property

by giving away full or part ownership of it, or you can create a trust and transfer the property to the trust.

At the moment, however, this section looks at the tax reasons for giving your things away while you're still alive. The two major possible tax advantages to giving things away are

- To reduce the capital gains tax your estate will have to pay when you die. Your estate pays capital gains tax as though you sold everything you owned on the day before you die. So, the less you own at the time you die, the less tax and probate fees your estate will have to pay.
- To reduce your income tax now. If you give away property that is earning income, the income earned by the property in the future will be paid to the new owner and should be taxed in the hands of the new owner.

Notice that these things are *possible* advantages. The balance of this section takes a look at each of them a little more closely, because neither of them is a sure thing.

Will you actually reduce capital gains tax for your estate?

A capital gains tax advantage for the estate occurs only if you give away capital property that has increased in value. This will be true for the real estate class of capital assets, where most property values have risen over the last few years. No capital gains tax advantage comes with giving away cash or cash-like investments such as GICs or Treasury bills, because they do not go up in value and so your estate will not have to pay any capital gains tax on the deemed disposition of these items when you die.

While it's true that if you give away capital property that has increased in value your estate will not have to pay any capital gains tax later, you may have to pay capital gains tax now! (And if the gift is to your spouse, and your spouse sells the property at a profit before you die, the CRA has the power to attribute the capital gain back to you; in other words, tax you as though the capital gain is yours.)

It doesn't usually make sense to pay taxes now if you can put them off until later. However, you may be willing to pay some capital gains tax now if you believe the property will increase in value a lot more before you die. It may also make sense to give away property now if you have a capital loss you can use to offset the gain, so that no tax will be payable.

Will you actually reduce your income tax now?

Even though the new owner of the property will receive the income from the property, *you* may still have to pay the tax on it. Depending on to whom you give the property, the CRA may attribute the income back to you and tax you as though the income continues to be yours. (The CRA will tax the income in the hands of the person who will pay tax at the higher rate.) Here's what the CRA can do:

- If you give income-producing property to your spouse or to a trust for your spouse, the CRA has the power to tax you on any interest or dividend income or any capital gains from that property in the future.
- If you give income-producing property to a child or grandchild under the age of 18, the CRA has the power to tax you on any interest or dividend income from the property in the future (but your child or grandchild will be responsible for any future capital gains). You cannot be taxed on the income earned by property you transfer to your adult child or grandchild.

Are you quite sure you want to give away your property? If the tax consequences of giving away your property don't put you off generosity, you still have a little more to think about. Whatever your reasons for considering giving your money or property away while you're still alive, ponder the matter carefully before you give up control over property that's important to you. You must also keep enough money and property for yourself so that you don't go from being financially independent to being dependent on others.

Should You Freeze Your Estate?

You may have heard people use the term *estate freeze* and wondered what they were talking about. Estate freeze can be used to describe any of several estate-planning techniques used to reduce the capital gains tax your estate would have to pay when you leave capital property to your children or grandchildren when you die. They are used for capital property that is expected to increase a lot in value in the future.

Estate freezes are all designed to transfer your property out of your hands so that you cap the amount of capital gains tax you'll ever pay. (You may have to pay capital gains tax on the current value of the property.) If the property goes up in value in the future, whoever gets the property from you — usually someone in the next generation or even the one after that — will have to pay capital gains tax on that *future* increase or increment.

Some estate freezes are really complicated and others are less so. No estate freeze is simple. Following are just a few types of estate freezes.

A gift as estate freeze

A gift of your property to a child or grandchild is a relatively simple form of estate freeze. When you give your property to your child or grandchild, you pay capital gains tax exactly as though you sold the property at its current fair market value. Your child or grandchild has to pay the tax on any capital gains that accumulate in the future.

Don't forget, you may get stuck paying annual taxes on income "attributed" to you from the gifted property as long as your child or grandchild is under 18!

A sale as estate freeze

Another way of creating an estate freeze is to sell your property to your child or grandchild at its current fair market value. You pay the capital gain based on the sale price of the property, and your child or grandchild will have to pay any future capital gains when the property is sold or otherwise disposed of. You can set up the transaction so that your child does not pay you right away but instead gives you a *promissory note,* which is a document in which your child promises to pay the sale price when you demand it. The advantage of using a promissory note is that you don't have to pay tax on the entire sale price at once; the CRA lets you spread out the capital gain over up to five years.

If you don't, in fact, want any money from your child or grandchild, you don't ever have to demand payment during your lifetime. (You'll still have to pay the capital gains tax either in a lump or spread out over five years.) Your child or grandchild will have to pay your estate the amount of the promissory note when you die (and can buy life insurance on your life to get the money to do so) unless you forgive the promissory note in your will.

A trust as estate freeze

In another form of estate freeze, you can set up a trust you manage for your children or grandchildren and give property to the trust. This will allow you to keep some control over the property. You have to pay capital gains tax as though you sold the property at its fair market value when you handed it over to the trust. You won't have to pay the tax on future capital gains; it will have to be paid by either the trust or the beneficiaries of the trust, depending on the circumstances:

- If the trust sells the property and continues to hold the proceeds of sale in trust, the trust will pay the tax.

- If the trust sells the property and pays the proceeds of sale to the beneficiary, the trustee decides whether the trust or the beneficiary will pay the tax.
- No tax is payable when the trust ends and the trustee transfers the property to the beneficiary, but the beneficiary takes over the property at the trust's adjusted cost base. (You can find more about what an adjusted cost base is in the section "Understanding capital gains" in this chapter.) When the beneficiary disposes of the property, he or she is taxed on the capital gain from the time the property was transferred by you to the trust.

A corporation as estate freeze

In all three of the preceding types of estate freeze, you have to pay tax now as the cost of handing over responsibility for future capital gains tax to your children or grandchildren. You don't have to pay any capital gains tax until you die in one type of estate freeze: an estate freeze involving a corporation. This kind of estate freeze is very complicated and is usually used to pass on a business or real estate investment.

You create a corporation and transfer ownership of property to the corporation in return for shares in the corporation. You give your children shares in the corporation as well. The corporation is organized using different classes of shares; you take shares that give you voting rights and control over the corporation, and you give your children shares that go up in value as the property goes up in value. If the estate freeze is set up properly, a rollover (similar to a spousal rollover) occurs when you transfer your property to the corporation, and the transfer doesn't trigger any capital gains tax at the time.

When you die, your estate pays capital gains tax on the value of your shares in the corporation — which will be the same as the value of the property when you transferred it to the corporation. If your children ever sell their shares, they will pay capital gains tax based on the increase in the value of the property from the time it was transferred into the corporation. (If the corporation, which is separate from the humans who control it, sells the property, it will pay capital gains tax based on the increase in value of the property from the time it was transferred to the corporation. The proceeds from the sale, less the cost of paying the tax, could then be paid out to the shareholder children in the form of dividends.)

Estate freezes involving trusts or corporations are not do-it-yourself projects. If you're thinking about an estate freeze, you need professional tax and legal advice. And if you have to stop to think about whether you can afford to pay for fancy advice, trust us, you don't need to think about an estate freeze — you don't have enough money to make an estate freeze worthwhile!

Should You Donate Something to Charity?

If you leave money or property to a registered charity, your estate will be able to claim a tax credit in your terminal tax return against the income tax it would otherwise have to pay. Your estate will be allowed to claim a tax credit of 15 percent of the first $200 in donations and 29 percent of donations from $200 up to the full amount of your taxable income reported in your final tax return. The amount of tax your estate would otherwise pay is reduced by the amount of this tax credit.

If the charitable donations in your will are more than your net income in your final tax return, your executor has the right to refile your tax return for the year before you died and use the remainder of the donation to get a tax credit to reduce that year's taxes after the fact. (Your estate will get a refund.)

You need to know how to make charitable donations in the right way in order to get the maximum tax benefits possible. The ways of donating include:

- **Gifts of cash made by will:** You can make a gift of a specified amount of money to the charity, or you can give the charity a share or percentage of the value of the residue of your estate — the *residue* is what's left in your estate after your executor pays your debts and taxes and hands out the gifts of cash and property you made to named individuals.
- **Gifts of specific property made by will:** Instead of leaving cash to a charity, you can leave specific property to the charity (a gift in kind) — for example, stocks or other securities, real estate, artwork, or a motor vehicle.
- **Gifts of life insurance:** If you think there won't be enough money in your estate to fund the charitable donation you'd like to make, you can donate the proceeds of a life insurance policy on your own life to the charity you've chosen. You can do this in two different ways:
  - You can donate the insurance policy to the charity while you are still alive.
  - You can hold on to your insurance policy and either name the charity as the beneficiary of the policy or name your estate as the beneficiary and leave the charity an amount of money equal to the life insurance proceeds in your will.
- **Gifts of RRSP or RRIF proceeds:** You can donate the proceeds of your RRSP or RRIF to charity. If you do, you can either name the charity as the beneficiary of the RRSP or RRIF or you can name your estate as the beneficiary and leave the charity an amount of money equal to the proceeds of the plan or fund in your will.

- **Charitable gift annuities:** You can make a donation to a charity while you're still alive in return for an annuity. An *annuity* is an investment bought from a financial institution, usually an insurance company. You pay the financial institution a lump sum in return for its promise to pay you a fixed amount of money every year for either a set number of years (a *fixed term annuity*), until you die (a *life annuity*), or until both you and your spouse die (a *joint life annuity*).
- **Charitable remainder trusts:** In a charitable remainder trust, you put income-producing property into a trust and get the income from the property for as long as you (or you and your spouse) are alive. The charity gets the trust property when you (or the second of you and your spouse) die.
- **Memorial donations:** If you want to donate to charity after your death, asking for memorial donations is a way of getting others to make the donation. It's not exactly cheating; you could think of it as "leveraging" your death. Or you could think of it as exercising power from beyond the grave (or urn) to encourage others to be charitable.

When the Taxman Finally Arriveth . . . With the Bill

In this chapter, you've discovered a number of ways you may be able to reduce the tax your estate will have to pay on the property you own when you die. But unless you leave everything to your spouse, your estate will have to pay something. To be prepared for that unhappy time:

- Estimate how much tax your estate will have to pay in your terminal return.
- Decide where the money will come from to pay it.
- Plan so the wrong person doesn't get stuck with the bill.

Estimating the tax

You can't know what property you will own when you die or what it will be worth. All you can do is estimate your taxes (over and above your usual tax bill) based on your present situation. To keep your estate plan current, you'll need to do this from time to time. Start by going to the "Your Assets" table (Table 1-1) in Chapter 1 of Book I and making a list of everything you own.

Make a list of everything you're *not* leaving to your spouse. Don't worry about property that will not be subject to capital gains, such as cash, GICs, Treasury bills, or your principal residence. Estimate your capital gain for each remaining piece of property by doing the calculation shown in Table 2-1.

Table 2-1 Estimate Your Capital Gains

	Current fair market value of property	$_____
–	Estimated costs to sell, if any	$_____
=	Adjusted sale price	$_____ (A)
	Purchase price of property (or fair market value of property when you acquired it, if you didn't buy it)	$_____
+	Costs of buying (if any)	$_____
=	Adjusted cost base	$_____ (B)
	A – B = Capital gain	$_____
×	50% (or × 0.50) = Taxable capital gain	$_____ (C)

When you have done this calculation for everything you own, add together the taxable capital gains figures for your total taxable capital gains and call it amount (D).

Now you know how much your taxable capital gains will be, but you're not finished yet. You haven't taken into account the tax you will have to pay on any RRSPs or RRIFs you do not leave to your spouse. Remember that the full value of your RRSPs and RRIFs will be taxed as income received by your estate. So add together the balances in all of your RRSPs and RRIFs and add that total to your taxable capital gains total. That combined total is the amount on which your estate will be taxed as a result of the gifts you are making in your will.

Use Table 2-2 to do the rest of the calculation.

Table 2-2 Add Deemed Income from Gifts of RRSPs and RRIFs

	Total taxable capital gains	$_____ (D)
+	RRSPs and RRIFs not left to spouse	$_____
=	Amount in your estate that is subject to tax	$_____ (E)

Finally, estimate the tax rate that will be applied to the capital gains and RRSPs and RRIFs. (For estimating purposes, you can do this here the lazy way.) After you dispose of all your capital property the day before you die, and after all of your RRSPs or RRIFs are rolled in, a very good chance exists you'll have made it into the top tax bracket. So assume a tax rate of 50 percent — if that's not true in your case, you'll be too embarrassed to tell anyone anyway. Use Table 2-3 to calculate your taxes.

Table 2-3 Calculate the Actual Amount of Tax Payable in Your Terminal Return

Amount in your estate (over and above your final year's income) that is subject to tax	$_____ (E)
x 50% = Tax payable	$_____

Where will the money come from?

When you have an idea of how much tax your estate will have to pay, think about where the money will come from to pay it. The CRA doesn't like to wait to be paid — although your executor may be able to work out a deal with them if difficulty occurs in paying the tax owing right away. Here are some options for paying the tax bill:

- Your estate may be rolling in cash and there will be enough of it to pay the tax.
- If your estate does not have enough cash to pay the tax, it may have valuable property that can be sold and turned into cash. If you would like your executor to sell (or not to sell) specific property, leave instructions in your will to that effect.
- If the estate doesn't have enough cash or you don't want non-cash property in your estate sold, you'll have to buy enough (additional) life insurance to cover the expected tax bill.
- If your estate owes tax money and simply does not have enough cash or property to cover the bill, the CRA can go after the executor personally if he or she transferred cash or property out of the estate to the beneficiaries before the taxes were paid. But if the executor didn't do that and there still isn't enough money to pay the taxes due in the terminal return, the tax authorities have to go whistle. They can't get it out of your executor or surviving family or friends.

Make sure the wrong person doesn't get stuck with the bill

You may have heard of situations in which one beneficiary receives a piece of property while another beneficiary gets stuck paying the taxes. That's because of a rule of estates law that the taxes and other debts of your estate are to be paid using the residue of your estate (anything you have not left as a specific gift to a specific individual) first, then out of cash gifts to specific individuals, then out of non-cash gifts (they'd have to be sold for cash, of course). Keep that in mind when you plan your gifts under your will. You can plan around this in several ways:

- Make sure you have enough cash, through insurance or otherwise, to pay all of your taxes so that gifts of cash to named individuals are not affected.
- Divide your estate among your beneficiaries in shares instead of leaving them specific property. That way they'll share equally in losses to tax or debt payments.
- State clearly in your will that the person who gets a particular piece of property is responsible for any taxes on that property. Then you won't run into the problem of one person getting the property and another person footing the tax bill.

Chapter 3

Creating an Estate Plan

In This Chapter

- Deciding on the people you want to provide for after you're gone — and knowing whom you *have to* provide for
- Understanding what an executor does, and choosing the right executor
- Making sure your children are protected in the event of your death
- Deciding what will happen to your business when you die

Captain on the bridge! That's you, the captain of your ship of estate. In the preceding chapters, you can find out about the reasons for estate planning, income tax concerns, and the main estate-planning tools. If you've read them, your response was probably a hearty yo ho ho, and a bottle of rum. Now it's time to start using what you've discovered — perhaps painfully (rum will do that to you) — and begin to create an estate plan.

The first step will be to assemble a crew for your estate — your beneficiaries (the people you will provide for in your estate plan) and your executor (the person who will manage your estate after you've sailed into the sunset).

Accounting for Your Beneficiaries

When you die, you have to give away everything you own. How will you figure out who gets your vast millions? This is the tricky part of estate planning — you can reward those who've been good to you and punish those who haven't by giving a gift here, withholding a gift there. Some people make a sordid hobby out of picking their beneficiaries, and then they proceed to revise their choices on an almost daily basis according to who has pleased them or ticked them off most recently. Perhaps it's their twisted way of wielding power.

Not everyone can afford the fantasy of planning their estate just to get even with their family, friends, and acquaintances. Most people have better things to do with their time. They have obligations, and those obligations may extend past the end of life. Sometimes, feelings and obligations match exactly, and you can choose a beneficiary without any trouble at all. But in other cases, the feelings and obligations are completely at odds (feelings: good, obligation: none; or feelings: bad, obligation: heavy), and it becomes more difficult to make choices. In this section, you find what you need to help you think about how to choose your beneficiaries, possibly including some people you wish were at the bottom of the sea.

In choosing your beneficiaries — and in deciding what to give them — you have to consider

- Whom you really *want* to provide for and whom you merely *have* to provide for
- Your reason for providing for them
- The best way to do the providing

The people you want to provide for

Unless you have the misfortune of coming from a totally dysfunctional family, it won't be difficult to settle on the people you actually *want* to give your money and belongings to. (And if you do hate everyone you know and would be keelhauled before you gave any of them a nickel, with luck you'll be able to leave everything to charity — preferably one that will really get up your family's noses.)

Rounding up the usual suspects

Take a look around you to see the beneficiaries whom you'll want to provide for. They're the people you live with or spend your time with. As we note in Chapter 1, who these people are may vary with your stage of life:

- When you're young and single, they're parents, brothers and sisters, friends, a charity, or a combination of these.
- When you marry or settle into a serious relationship, it will probably be your spouse or partner whom you want to get all or most of what you own.
- When you have young children, they'll likely be first on your mind.
- If you divorce, your children or other relatives will be at the top of the list, and your former spouse may or may not be right off it.
- When your children are grown up and self-sufficient, grandchildren or a favourite charity may attract your attention.

What's your reason for giving?

You may want to include certain family members or friends in your estate plan for many reasons. The particular reason you have in each case will affect what you decide to give and how you go about giving it.

You may want to include someone in your estate plan in order to

- **Provide ongoing support.** Your spouse or children, or some other relative or friend, may need your financial assistance. It may take the bulk of your estate to do it.
- **Help meet a particular goal.** Finishing a university degree, starting a business, or buying a house requires cash. A gift of a specific amount of money will do the trick.
- **Say thank you.** An employee may have been very loyal, or a friend may have been especially kind when you were sick or in some kind of trouble. A gift of money or one of your personal possessions may be the answer.
- **Pass on a family heirloom.** You may have received furniture, photographs, or papers from your parents or grandparents that have been in the family for generations or that have special significance for your family. You'd like the heirloom to go to a relative who will value it and pass it on in turn.
- **Leave a memento.** A family member may have admired a piece of your jewellery, or a friend may have shared your passion for collecting belly dancer figurines. A gift of a particular item would be appropriate.
- **Show that he or she was in your thoughts.** A gift of one of your personal possessions or a small sum of money will be appreciated.

What's the right tool for making the gift?

The most obvious way to give to your survivors is to leave money or property in your will. But, as discussed in Chapter 1, you can provide for your beneficiaries in other ways:

- **Life insurance:** You can name someone as beneficiary of a life insurance policy, and your beneficiary will receive the insurance proceeds directly.
- **RRSPs and RRIFs:** You can name someone as beneficiary of your RRSP or RRIF, and your beneficiary will receive the RRSP/RRIF proceeds directly.
- **Pension plans:** If you are a member of a defined benefit or defined contribution employee pension plan, you may be able to name a beneficiary to receive a pension or a one-time payment after your death.
- **Joint ownership of property:** If you own property jointly with another person, when you die your share in the property will automatically pass to the surviving owner without your having to mention the property in your will.

That's the how. Now what about the when? When do you want the person to get the money or property? Timing will also affect your choice of estate-planning tool. You may want to provide for someone

- **While you're alive:** That means a gift or a living trust.
- **Immediately after your death:** That means making a gift in your will or naming the person as a beneficiary of your life insurance policy or your RRSP or RRIF.
- **After you die but not until someone else also dies:** You may want your children to inherit your property, for example, but not until after the death of your spouse. That means setting up a trust in your will to give your spouse the use of the property during his or her lifetime, and to hand the property over to your children when your spouse dies.
- **After you die but not until the person reaches a certain age:** You may not want your children to have total control over the inherited property until they are 25 years old, for example. That means setting up a trust in your will to keep your money invested for your children until they turn 25, and then to give them the property outright.

Should you give to children directly or indirectly?

If you have children under the age of majority to deal with, you have some special concerns. You must decide whether to provide for them by making a gift to the children themselves or by making a gift to their parents (and benefiting the children by a trickle-down effect).

If you are married with young children, you certainly want to make sure your children are supported after you die, but that doesn't necessarily mean you have to give money to them directly by naming them as beneficiaries of your will and/or insurance policies. You can achieve your purpose by leaving your estate to your spouse, who will use it to support your children.

If you're dubious about what your spouse will do with the money, then you must name your children as beneficiaries to make sure they are provided for. But if you want to leave money for your children, you must set up a trust in your will that will invest the money for the children, pay out income and capital as necessary, and turn the entire fund over to the children when they grow up.

If you give a large sum of money directly to a minor child (under age 18 or 19, depending on the province), the provincial government will step in and put the money into a trust. The trust will be managed by a government official (called the *public trustee* or *public trustee and guardian* in most provinces) and turned over to the child when he or she comes of age. Many people aren't all that keen on the way the provincial government manages their tax dollars and would be less than thrilled to have the government managing their personal money.

If you have grandchildren, nephews and nieces, or other children whose lot in life you'd like to improve, the question still arises — do you want them to benefit directly or indirectly? If you want the child to have a direct benefit, you can make a gift to be held in trust until the child comes of age.

If you have education in mind, you can even set up a registered education savings plan (RESP) to help the child with university, college, or trade school expenses. If you think it would be better to benefit the child indirectly, you can give a gift to the child's parents and make the entire family's finances healthier.

The people you have to provide for

You may see some people in your life more as ballast than crew. They're the people you have to provide for even though you may not want to — they have to be in your estate plan too.

You may think you can do what you like with your property when you make your will, but you're wrong. For centuries, people making wills could do pretty much what they wanted — they had the *right of testamentary freedom*. However, since the early years of the 20th century, certain limits have been placed on that freedom. Nowadays when you're making plans, you have to take into account the possibility that, after you've passed on, claims will be made against your estate by

- People who are dependent on you for support.
- Your spouse.
- People you've promised to provide for.

People who are dependent on you for support

Have you been giving money to certain family members or old pals for years and think it's high time they stood on their own two feet? So far, you've never been able to work up the nerve to tell them you're turning off the tap, but you're looking forward to doing just that in your will. Well, some bad news is in store for you — death is no certain escape from those relatives and friends who have attached themselves to you like barnacles.

Whatever province you live in, a law exists to make sure your dependants — certain people you are required by law to support — will be looked after out of your estate.

The definition of a dependant varies from province to province. In some provinces, only children or legally married spouses can be considered dependants. In other provinces, unmarried spouses, parents, grandparents, or siblings can also qualify as dependants.

A person won't necessarily be considered a dependant just because he or she is related to you. The person must also be someone whom you were supporting (or under a legal obligation to support) at the time of your death. Likewise, a person won't be considered a dependant just because you were supporting him or her before you died. There must also be a recognized relationship between the two of you.

For example, your deadbeat friend who has been sleeping on your basement sofa and whose car loan you have been paying for the last six months would not qualify as a dependant. But your own child under the age of majority would qualify as a dependant whether or not you are providing support for him or her.

Provincial law allows a dependant to make a claim for support from your estate if you do not leave him or her enough money in your will. A judge would decide whether to provide for a dependant out of your estate by looking at things such as that person's other sources of income and ability to earn a living.

Dependants are given a fixed period of time, usually six months, in which to make a claim by starting a court action. Your executor cannot legally start giving your estate away to your chosen beneficiaries until the time limit for these claims has passed and no claim has been made.

When someone has made a claim, your executor will not be allowed to give anything to your beneficiaries without first getting a court order, or else getting the consent in writing of everyone who has the right to make a claim against your estate as a dependant. If your executor does give any of your estate to your beneficiaries without consent or a court order, the executor could really land in the drink. He or she may personally have to pay the dependant if not enough money is left in the estate.

If you have been supporting someone, or know or think you have a legal obligation to support someone, tell your lawyer when you're making your will. Your lawyer can determine whether or not that person has the right to make a claim against your estate as a dependant. If the person does have a right, it's probably wise to leave enough money in your will to support him or her. (Your lawyer will be able to help you figure out how much that is.)

You don't stand to gain much by trying to leave a dependant out of your will. A dependant with any gumption will get the money out of your estate anyway — and your other beneficiaries won't get anything until the claim has been dealt with.

Your spouse

In addition to being able to make a claim against you as a dependant, in some provinces your spouse may have rights to claim a minimum share of your estate. Some provinces have passed family law legislation designed to give a

surviving spouse the same rights to a division of property that a spouse would have on a marriage breakdown. So if you're thinking that death would be a cheaper escape from your marriage than divorce, think again.

Like dependants, your spouse has a fixed period of time, usually six months, in which to make a claim by starting a court action. Your executor can't legally give any of your estate to your chosen beneficiaries until the time limit has passed without a claim, unless your spouse consents. If your spouse does make a claim, your executor will not be allowed to give anything to your beneficiaries until his or her claim is settled, unless your spouse consents. If your executor does give any of your estate to your beneficiaries without consent, the executor may personally have to pay some or all of any amount that a court later awards to your spouse.

Looks like "'til death do us part" is a bit off the mark, doesn't it? Even if you're looking forward to death as a way of fleeing the clutches and financial demands of your spouse, if you live in a province that gives spouses a right to a share of an estate, you have to leave your spouse the required amount.

When you talk to your lawyer about making your will, your lawyer will ask if you are married or separated. He or she will tell you whether or not your spouse has the right to make a claim for a share in your estate. If your spouse does have a right, you'll probably have to leave him or her enough money to satisfy it. (Again, your lawyer will be able to help you figure out how much that is.) As with your dependent relatives, little is to be gained by trying to leave your spouse out of your will.

People you've promised to provide for

Generally speaking, if you promise a person you'll make a provision in your estate, he or she can't force your estate to carry through on your promise. That only goes for ordinary, run-of-the-mill promises, though. If your promise is contained in a contract, the person to whom you made the promise may be able to make a claim against your estate.

This kind of promise is most commonly found in separation agreements. A separation agreement may contain a promise by one of the spouses that

- His or her estate will continue to make support payments to a spouse and/or children. If you have made this kind of promise, make sure you earmarked enough money in your estate for support payments. (Your lawyer will probably suggest that in your will you give your executor the right to try to negotiate a one-time payment to replace ongoing payments.)
- He or she will maintain a life insurance policy in a specific amount naming the spouse and/or children as beneficiaries, failing which the estate will be required to pay a fixed amount of money to the spouse and/or children. If you have made this kind of promise, make sure you've got that life insurance in place!

If you have signed a separation agreement, show it to your lawyer when you go to talk about preparing your will.

The people you decide not to provide for

Finally, some people in your life have walked the plank — you don't want to give anything to these people, don't legally have to, and don't intend to. In your estate plan, pay attention to these people as well.

What if you don't want to leave anything to someone who is a close relative? You've got your reasons. Perhaps you've already given a gift of money or property, or you believe he or she doesn't need your money and property but other relatives do. Maybe you once made a substantial loan that was never repaid. Or maybe you just can't stand this person, and the two of you have been quarrelling for years.

A close relative who feels entitled to be included in your will may be tempted to go to court to try to have your will set aside after your death. If your will does get set aside, then you have no valid will — and provincial rules about who shares in your estate if you die without a valid will (that is, if you die *intestate*) take effect. Depending on how close this relative is and what other relatives survive you, he or she may manage to get a chunk of your property.

Offer an explanation in your will if you are leaving a close relative little or nothing. If you don't say anything at all about this person, the troublemaker could argue to the court that failing to remember him or her at all was evidence your mind was in tatters when you made your will. If you mention the person and give a reason for cutting him or her out, it will make an attack from that quarter more difficult.

Understanding Your Executor

You get to be captain on your ship of estate, but you need someone to carry out your orders when you're down in Davy Jones's locker. That's what your executor is for.

It will give you a jaunty, nautical air if you refer to your executor as your "XO" (no, it doesn't mean love and kisses; it stands for *executive officer*). Or, possibly, it may send your family looking for your power of attorney and living will, convinced you are no longer mentally capable of managing your own affairs.

What does an executor do?

Before you can decide whom to name as your executor, know what it is your executor will have to do. Not everyone is cut out to be an executor, so you'll want to choose yours carefully.

Your executor (called a *liquidator* in Quebec and an *estate trustee with a will* in Ontario) must do the following:

- **Make your funeral arrangements.** An executor usually checks to find out whether you left any instructions, and consults with the family about what you might have liked, but the executor has the legal responsibility to make your funeral arrangements and has the final say about them.
- **Collect information about your estate.** Your executor has to get a reasonable amount of information about the property you own and your debts (including the approximate value of both) in order to apply for letters probate, and locate and gather your property.
- **Protect the property of your estate.** Your executor has to make sure that valuables (house, car, jewellery, artwork, and so on) are kept safe, and that the property of the estate is properly insured. If you leave behind a business or investments that need active attention, your executor has to look after them personally or else hire a skilful person to manage them.
- **Apply, if necessary, for *letters probate*** (known in Ontario as a *certificate of appointment of estate trustee with a will*). In order to administer your estate, your executor must be able to prove to the world that he or she has the legal authority to do so. The best proof is letters probate, a document from the provincial surrogate or probate court certifying that your will is valid. (Your executor may or may not have to apply for letters probate depending on the size and complexity of your estate.) In order to get letters probate, your executor will have to estimate the value of your estate and have the estate pay probate fees (in almost all provinces, probate fees are based on the total value of your estate).
- **Gather the property belonging to your estate.** Your executor will have to track down everything that you owned and that now belongs to the estate, and, if necessary, transfer the registration of things that were in your name into the estate's name (real estate, vehicles, bank accounts, investments). Property that your executor must track down includes insurance proceeds, pension benefits, and survivors' benefits that are owed to your family. Your executor should also look after a few investments that bypass your estate, such as RRSPs and RRIFs if you have designated beneficiaries.

- **Make an inventory of the property in your estate and value the property.** Your executor has to have a reasonably good idea of the value of your estate in order to get letters probate. But in order to complete your terminal tax return, your executor will have to know your exact income in the year you died, as well as the exact present value of your capital property *and* its value when you got it (for capital gains tax calculations). See Chapter 2 for more on capital gains taxes.
- **Keep the money and investments in your estate properly invested.** Your executor has to stash your cash in a safe place until he or she pays the estate's debts and taxes and distributes the remainder of the estate to the beneficiaries. An executor has to choose conservative, low-risk investments, unless you give special instructions in your will (for example, that playing the futures market is okay). Your beneficiaries can sue your executor for making bad investments and reducing the value of the estate before it's given to them.
- **Pay debts and taxes.** Your executor must find out to whom you owed money (your creditors) and then pay them, and must also file your terminal income tax return and any outstanding past returns (and, as time passes, estate tax returns) and pay income taxes due. All payments come out of the estate, not the executor's pocket.
- **Distribute your estate to the beneficiaries.** Your executor has to hand over the property in your estate to your beneficiaries, following the instructions in your will. This can be done after the CRA has given the release that all outstanding taxes have been paid. If your will creates a trust naming your executor the trustee, he or she will continue to hold on to the trust property and manage it on behalf of the beneficiaries of the trust, in accordance with the instructions in the will.
- **Account to the beneficiaries.** Your executor will have to give a statement to the beneficiaries that sets out what money and property was received and paid out on behalf of your estate.

An executor sometimes earns a fee for doing the required work. This fee is taxable. Consequently, many wills are now stipulating that the executor earns 2 percent of the estate as a beneficiary rather than 2 percent as a fee.

What are the legal responsibilities of an executor?

Your executor is a kind of trustee who must do the following:

- Follow the instructions set out in your will.
- Obey provincial laws about trusts.
- Act with the greatest trust, loyalty, and honesty.

- Deal with the property of the estate the same way a reasonably prudent businessperson would handle his or her own property.
- Act in the best interests of the beneficiaries and not favour some beneficiaries over others.
- Ensure that art, jewellery, fine wine, rare books, and other such items are all appraised professionally and second opinions sought where necessary.
- Carry out duties personally and not pass them off to someone else (although it's okay for the executor to have professionals working for him or her, such as having a lawyer get letters probate or an accountant prepare tax returns or an investment adviser give investment advice).
- Not try to make a personal profit from the estate or get a good deal for himself or herself on property from the estate.

Choosing your executor

Clearly, acting as an executor is not going to be as easy as falling out of a crow's nest. That means you don't want to choose someone who's going to have trouble fulfilling the role because his or her business or management skills are too limited to deal with the kind of property you're leaving. You also don't want to choose someone who won't want the job (a person named as executor doesn't have to accept) or who doesn't have time to do it. Likewise, you'd prefer to avoid someone who's not likely to last as long as your estate — if you set up a trust for young children, for example, you don't want to name an executor who has one foot in the grave. Last but not least, you don't want an executor who's going to have trouble getting along with one or more of the beneficiaries, or who may find it hard to treat certain beneficiaries fairly.

Have a look at your potential crew members. Does anyone there fill the bill? You needn't panic just because your family and friends are normal human beings instead of lawyers, accountants, or seasoned entrepreneurs. Most executors do not administer the estate all on their own. They hire a lawyer and perhaps an accountant to carry out many of these tasks. So if your estate is relatively simple, anyone who is honest and has good common sense and at least enough sophistication to work with a lawyer and/or accountant can be your executor.

If you think it will take more than one person to handle the challenge, you can name two or more individuals as co-executors. If your estate is complex, you can name a trust company such as RBC Investments or TD Canada Trust (their services may be expensive) as your executor, or as a co-executor with an individual. If you decide to go for co-executors, though, keep in mind that they have to act unanimously unless you say in your will they don't. Think about which would be worse — requiring your executors to agree about everything, or letting each one act alone?

Oh, and by the way, think about naming an alternate executor, especially if you've chosen to go with a single executor. If you don't name an alternate executor and the executor who's your only choice dies before you or refuses to act, someone will have to come forward and apply to the court to be made the administrator of your estate. If your executor dies after you and you haven't named an alternate executor, your executor's executor will become your executor.

When your executor's not quite up to the job

Suppose you feel you have to name some particular person as your executor in order to avoid hurting his or her feelings deeply, even though he or she isn't quite up to the job. Your spouse, for example, may be very offended at being rejected for the post.

You can take steps while you're alive or in your will to help the landlubber executor — throw a lifeline, as it were. For example, you can pair this executor with a more skilled and experienced executor by naming a more business-savvy friend or relative as co-executor. If your estate is complicated and has enough money to pay the extra fees involved, you can name a trust company, or a professional, such as your lawyer or accountant, as co-executor. Or you could start introducing your executor to your affairs gradually while you're alive and well (and hope you don't kick off before the executor gets the hang of them). You could also put together a team of professional advisers (lawyer, financial consultant, professional accountant, and investment adviser) and let your executor know they'll be available to help when the time comes.

What can happen if you choose the wrong executor?

Your executor is the linchpin of your estate plan. If you choose the wrong one, your plans can be seriously messed up. For example, an executor who is unwell or old and feeble when you die may drop out or die before his or her duties are completed. But that's not really such a big problem. One way or another, you'll still end up with an executor (your alternate executor, for example). But executors can do worse than get sick or bite the dust. An executor who performs the job incompetently or dishonestly can be bad news, big time.

An incompetent executor may:

- Fail to file appropriate tax returns, leading to extra tax payments in the form of interest and penalties, and extra attention from the CRA.
- Fail to take advantage of various tax-saving strategies such as making an RRSP donation or tax-free rollover of certain qualified assets to your spouse, or taking advantage of unused capital losses, with the result that your estate loses money to the tax authorities unnecessarily.
- Pay debts that should be challenged (so your estate loses money) or fail to pay all your legitimate debts (so your estate is sued).
- Make poor investment decisions, so your estate doesn't increase in value as it could or even loses money.
- Distribute your estate before your debts and taxes are paid (with the result that the executor may have to pay some of them personally — ha ha, serves the twit right).
- Distribute your estate to the wrong beneficiaries or in incorrect shares or amounts.

A dishonest executor may:

- Steal money from your estate, either by pocketing estate money outright or by overpaying himself or herself for services as the executor.
- Put his or her interests ahead of those of your estate, for example by buying property from the estate for a low price, or by directing paid estate-related work to himself or herself, friends, or family.
- Deliberately favour one beneficiary over another.

Your solution: Make sure you've got an alternate executor — and, if necessary, a trust company as an objective and impartial executor of last resort.

To avoid most nasty surprises, discuss the executor responsibilities with the candidates before you die. Introduce your executor to your spouse, your children, your lawyer, and your accountant, because they'll all be working together.

Looking Out for Your Children

Fairy tales were scary when you were a kid, even when they had a happy ending. Now that you have kids yourself, some fairy tales are even scarier because you find it harder to believe in the happy ending. And the scariest of all fairy tales are the ones about orphaned children.

Hiding under the covers or asking for a night light to be left on won't help. You may as well know what will happen to your children under the age of majority if you die before them — and what you can do to try to make sure they'll be safe and well cared for even though you're not there.

Before we get into what will happen to the kids if you die, we'll tell you what the law says about who cares for the kids when their parents are still alive. This will delay the stuff about orphans, which you really don't want to hear about, and make it easier to understand when you get there.

In every province, both living parents are the guardians of their children. That means they are both responsible for caring for the children and they both have the right to make decisions about how the children are raised — where they should live, what faith they should be raised in, where they should go to school, and what medical treatment they should have.

This two-parent, two-guardian arrangement is hunky-dory if both parents live together. Things get a little less hunky-dory and a little more complicated if the parents are separated or divorced. Then they will have to agree who will have custody of the children.

Custody and guardianship mean pretty much the same thing. The person who has custody of the children is the person with whom the children live and who cares for the children and makes the decisions that affect their lives. (This can be viewed as a responsibility or a privilege, depending on how your day has gone so far. By the way, what was that crashing noise coming from the kitchen?) The parents may agree they will continue to share custody in some way — such as joint custody, which allows both parents to have a say in how the children are raised — or they may agree that only one of them will have custody.

If separated parents can't come to an agreement about custody, the courts will decide for them. Judges often prefer joint custody arrangements. If that's impossible because the parents won't cooperate, judges make their decisions by assuming both parents have an equal right to care for their children but that custody should go to the one who can care for them best.

You can't put the scary part off any longer because Book VII is about wills and estate planning, not about baby and child care. The balance of this section tells you what will happen to your kids following your death if you make no plans for their care. We start with the least upsetting scenario, but matters will rapidly go downhill after that.

If one parent dies but the other is still alive and has custody

What happens to the children on the death of the first parent depends on the custody arrangements that existed beforehand.

If the parents were sharing custody — either because they were living together as a family, or because, although separated or divorced, they had agreed to a joint custody arrangement, or because a court had ordered a joint custody arrangement — the surviving parent simply carries on as sole guardian of the children.

If one parent dies and that parent had sole custody

If the parent who died had sole custody of the children, a number of things could happen:

- Someone, perhaps the surviving parent, the new spouse of the parent who died, or a grandparent will come forward and offer to look after the children.
- More than one person — surviving parent, new spouse, grandparents, and maybe other relatives — will put in dibs on the kids and there will be a long, drawn-out, expensive fight over who gets to care for them. If the kids are this lovable, they may have a future in the entertainment business.
- No one will offer to take the children. The surviving parent may not want them and there may be no other close relatives or friends who feel a moral obligation toward them — or else everyone who *may* feel a moral obligation is already acquainted with the children. Having enjoyed the spectacle of them tearing around like banshees when they were not murdering each other over the TV, the toys, or the right to monopolize the bathroom, all potential caregivers run screaming in the opposite direction. Sadly, this may also be the case if a child has a disability and needs extra care.

If only one person wants custody

Perhaps only one person is interested in caring for the children. Or the entire family may have discussed the situation and agreed that a particular family member should care for the children.

The person who wants custody or guardianship of the children will have to apply to the court for a formal custody order. In a few provinces, a surviving parent who was not a guardian (because of an agreement or court order giving custody to the other parent alone) automatically becomes the guardian and does not legally need a court order. But even when no legal requirement to get a court order exists, a formal order may be necessary to allow the guardian to receive any money for the children's care and upbringing that was left by the parent who died, to register the children in school, or to consent to medical treatment on the children's behalf.

When an application for custody is made, the court has a duty to make sure the person applying is capable of looking after the children and has a reasonable plan for their upbringing. This is true even if no one comes forward to oppose the application.

If a custody battle occurs

If the kids are popular and a fight erupts over who gets them, the court decides who gets custody. The judge hearing the application will base his or her decision on the best interests of the child. This means the judge will want to hear about such things as:

- The family relationship between the children and each person claiming custody.
- The emotional ties between the children and each person claiming custody.
- The existing living arrangements between the children and any person claiming custody.
- The ability of each person claiming custody to look after the children.
- The plans of each person claiming custody for the care and upbringing of the children.
- The stability of the family life of each person claiming custody of the children.
- The children's point of view — in some provinces, they are even entitled to a lawyer to put their interests forward.

How these factors would play out in an actual custody battle would depend on the particular circumstances of the case. A biological parent has a real advantage, even if he or she was not the greatest parent before the other parent's death. Unless the surviving biological parent is seriously unfit to look after a child, the courts will likely grant him or her custody. The only competition to watch out for is a relative or friend with whom the children lived before the death of the first parent. And the preferences of an older child are very important.

If no one wants the kids

If no family members or friends are willing and able to look after the children, the children will be considered *children in need of protection* under the province's child welfare legislation.

We don't operate orphanages in Canada anymore, so put out of your mind the sad picture of your children trudging up the steps of some grey and soulless institution. But don't worry: Plenty of other sad pictures can replace that one. The children will be placed in the care of a child and family services agency, which will try to find them a foster home. (They make an effort to keep families together in one foster home, but it's not always possible.) The children may be adopted, especially if they're quite young, perhaps by the foster parents or perhaps by someone else.

Child and family services agencies are fairly careful about picking foster parents, and they keep an eye on the children in foster care. The adoption process is quite lengthy and is geared toward investigating the adoptive parents to make sure they're fit. But even a kind foster family or adoptive family isn't the same thing as *your* family.

Children who are not adopted are on their own as soon as they come of age (18 or 19 depending on the province). If they inherited property from the parent who died and that parent made no special trust provisions, the children will also receive the property as soon as they come of age. So your teenagers could be running around with no one to supervise them and their pockets full of cash — or with nothing in their pockets at all.

If both parents are dead

Now for the orphans. If the children have only one surviving parent who then dies, or if both parents die at the same time, the result will be the same. No person has an automatic right to take over custody of the children.

The options are the same as in the circumstance of the death of a parent who has sole custody of the children. If both of the children's parents are dead:

- One person may offer to look after the children. It will be up to the courts to decide whether that person is suitable — and if he or she is not, then the children will be turned over to the child and family services agency as a child in need of protection.
- Several people may offer to look after the children and then there will be a custody battle over them — but in this case no one has the advantage of being the children's parent, so the outcome of the fight may be harder to predict. With luck, at least one of the people who want custody will be someone the courts think is fit to have custody.

- No one may offer to look after the children. Then, once again, the children will be handed over to the child and family services agency.

Appointing and safeguarding a testamentary guardian

A testamentary guardian is a person appointed in a parent's will to look after the children. In almost every province, a parent can appoint a testamentary guardian — but making the appointment won't necessarily dissolve all parental worries. The effect of appointing a guardian depends on the province the family lives in and whether a surviving parent remains.

If the other parent survives the testator

If the parents shared custody of the children and only one parent dies, the surviving parent will continue to be the guardian of the children. It doesn't matter that the parent who died named a different guardian-by-will — the deceased parent can't terminate the surviving parent's right to be guardian of the children. In some provinces, the appointment of the guardian has no effect at all in these circumstances, and in most other provinces, the surviving parent can go to court to remove the guardian named by will. In a couple of provinces, the guardian-by-will can act as guardian, but has to act jointly with the surviving parent.

If the parent who died had sole custody of the children and the other parent survives, the surviving parent does not automatically become the guardian. But neither does the guardian appointed by will. Anyone who wants custody of the children will have to go to court to get it, and if more than one person is asking for custody they'll have to duke it out in front of a judge.

The surviving parent has the better chance of getting custody unless he or she is really an unfit parent. If the parent is unfit, then the guardian appointed by will may get the nod, so too if the children have been living safely and happily with the guardian. But because the judge has to decide what to do based on the best interests of the children (see the section called "If a custody battle occurs" in this chapter), not on the wishes of the people asking for custody, it's possible the judge won't give custody to either the surviving parent or the guardian appointed by will.

If one parent is already dead and then the second parent dies

If the second parent to die appointed a guardian-by-will, in almost all provinces the guardian will get custody of the children if the guardian agrees to the appointment — unless someone else applies to be guardian (and/or asks the court to remove the testamentary guardian). Then it's up to the courts to choose the guardian.

In some provinces, it's up the courts even if no one else wants custody or objects to the guardian: The appointment under the will lasts for only 90 days. During that time the guardian-by-will must apply to the court for a formal custody order. In the other provinces, no legal requirement exists for the guardian under the will to get a court order granting custody. However, such an order may be necessary or at least desirable if the guardian wants to receive money left for the children's care, to register the children in school, or to consent to medical treatment for them. Financial institutions, schools, and doctors are apt to want proof of guardianship, and it's more reassuring to them to see a court order than a will.

If a guardian is appointed by will but other relatives and friends want custody in spite of the testator's choice, then everyone goes roaring off to court. In choosing among the various applicants, a judge doesn't have to decide that the guardian under the will is unfit before picking someone else to have custody. The judge will take the testator's wishes into account, but will make a choice based on the best interests of the children. (This takes you back to the section on custody battles again.)

Sounds like the guardian-by-will may spend more time in court than with the kids. A testator who doesn't want the chosen guardian to feel oppressed (or bankrupt) from the very beginning should include a provision in the will that the estate will pay the guardian's legal costs.

What you can do to safeguard your choice of guardian

You looked your family and friends over and chose as testamentary guardian the person you thought would best care for your children. But when you're gone, your choice won't necessarily be respected. People you rejected out of hand may show up yelling "Me, me!" and the judge (who's never met you, your kids, or any of the would-be guardians) may second-guess you and make his or her own choice. Is there any way you can get a little more control over the situation?

You may have noticed that "the best interests of the children" is a recurring theme when it comes to awarding custody. In order to make your choice of guardian stick, you can try to arrange things so the court will be convinced that going with your choice will also be acting in the children's best interests.

How do you perform this trick? (No, flying monkeys are not the answer.) You have to start while you're still alive. When you choose someone to be guardian, if possible choose a person whose relationship with your children satisfies a good number of the "best interests of the children" factors. Look for a potential guardian who

- Is a relative (by blood or marriage).
- Has strong emotional ties with the children.

- Is living with the children (if not, then a person with whom the children would like to live — of course, your children may be at a stage when they'd like to live with anyone except you).
- Is able to look after the children.
- Can come up with good plans for the care and upbringing of the children.
- Lives in a stable family relationship.

And don't forget, the potential guardian should be someone who'll agree to be guardian. Make sure you ask before sticking a name in your will. "Sneak-up" or surprise guardianship doesn't work too well (just as we discussed earlier with surprise executors).

What if you don't know anyone who has a close relationship with your children — the kind of relationship the court will be looking for when deciding whether your choice of guardian is okay? Then it's time to get to work and create such a relationship. Keep in touch with whichever members of your family you consider fit to look after your kids, and encourage some bonding between them and the children. If your family looks hopeless, see whether any of your friends are suitable. And don't pin your hopes on just one individual — you may want to name an alternate guardian in your will in case your first choice gets cold feet. Faraway children look greener.

The duties of a guardian

In fairy tales, the duties of a fairy godparent are pretty much restricted to showing up in the nick of time to rescue the child hero/heroine just when all seems lost. A guardian works harder and gets less time off — and doesn't get a magic wand that actually turns mice into pumpkins.

Guardian of the person and guardian of the property

If a person is appointed the guardian of a child and nothing is said to limit the guardian's appointment, that person has the right and the responsibility to

- Care for the child and make decisions about how the child is raised (have custody of the child)
- Look after the child's property

You may appoint one person to care for the child (to be the child's *guardian of the person*) and another person to look after the child's property (to be the child's *guardian of the estate* or *guardian of the property*). In a will, it is usual to name a guardian of the person, and to make the executor the guardian of the property. The two guardians may be the same person or they can be different people.

Instructions for the guardian(s)

Instructions to the guardian of the property are usually left in the will. It's best to set up a testamentary trust for minor children, and then the person looking after the property will be your trustee.

Instructions to the guardian of the person should be discussed face to face with the guardian. The better your chosen guardian knows you and your children, the more likely it is he or she will know your values and have a sense of the way you would like your children to be raised. You may also want to leave a detailed letter for the guardian with your will, in which you set out your wishes about your children's general upbringing, their religious training and education, and the values you would like them to have (fiscal conservative with a strong social conscience or bleeding heart liberal? Pepsi or Coke? Sponge Bob or Thomas the Tank Engine?). These instructions are not legally binding, but they will give the guardian some guidance and perhaps comfort. The letter will also be a useful tool in the guardian's hands when your children claim that if their parents were still alive they would have let them ____ (fill in the blank).

Protecting Your Business

Nearly two million Canadians own their business or professional practice, either alone or with others. Are you one of them? And have you ever dreamed of your business being handed down from generation to generation . . . your portrait hanging on the boardroom wall . . . maybe even a bronze statue of you outside the head office . . . your descendants and their employees speaking of you in reverential tones as "our founder"?

Maybe that's not your fantasy at all. Maybe you'd just as soon your kids didn't follow you into the business you're in. But even so, you'd probably like to pass its value on to your family by selling the business and leaving them the money.

This much is sure: If you own your own business, deciding what to do with it is an important part of your estate planning. And deciding what to do isn't the end of it — you've got to take action, too. Whatever your decision about your business, it's much more likely to work out if you make plans than if you leave everything to chance.

Your main choice lies between keeping your business in the family and selling it to someone outside your family. However, it's not necessarily up to you to decide what to do with your business.

If you're a sole proprietor or the sole or majority owner of the shares of a corporation, the decision is pretty much yours. You own the business and you can do what you like with it. You'll have the power to hand it over to your family if that's what you want to do, or to sell it if you prefer.

If you are a partner in a business or a minority shareholder in a corporation, your choices are more limited. Your business associates very probably have a big say in what's going to happen.

You may already be sold short

If you have partners or if you have fellow shareholders who together hold more shares in the corporation than you do, you don't have total control over your business. Whether you want to sell or you want to bring your family in, your partners or the other shareholders will want to stick their oar in. They may be able to prevent you from sharing ownership of the business with family members or passing ownership on to them. And they may be able to prevent you from selling your ownership interest to an outsider.

If your business is a partnership

To be frank, it's rather unlikely you will be able to transfer your interest in a partnership to a family member either during your lifetime or on your death.

You can transfer your partnership interest in an ongoing business to someone else (including a family member) only if your partners consent to the transfer. And they won't consent unless they think exchanging you for your family member is good for the business and for them as well. If a partnership agreement exists, it may require you to transfer your interest directly to your partners if you want out. And you can't add a new partner or partners without the consent of your existing partners.

If you die while still a partner in a business, you can't just leave your partnership interest to a family member and assume he or she will take your place. If you have a partnership agreement, it probably requires your partners only to pay your estate for your interest. It almost certainly doesn't say the partnership has to take on someone you choose to replace you. If you don't have a partnership agreement, the partnership dissolves on your death. Then your family members simply inherit your share of any property belonging to the partnership. It would be up to your former partners and your family to decide whether they wanted to re-form the partnership together.

If your business is a corporation

If your business is a corporation, you have to bring in new owners by transferring shares in the corporation to them. Anyone can buy shares in a public corporation on the stock market (although usually only the very rich can buy

enough shares to get any kind of control over the business). But in a private corporation — which is the only kind of corporation you would be turning over to your family or selling to an outsider — the shareholders and/or the directors of the corporation have to give their consent before shares can be transferred. If you're not the only shareholder or not the majority shareholder of your corporation, it may be difficult or impossible to persuade all the necessary people to allow you to transfer your shares to a family member, or to anyone else for that matter. Just like partners, shareholders and directors don't want new owners wandering in off the street. (You'd also need consent to get the corporation itself to give or sell new shares to your family member.)

In addition, if you're thinking of selling, an outsider is unlikely to want to buy a minority share in a private corporation, even if the other shareholders agreed to the purchase. Actually, your family member might not thank you for a minority interest either. The only real market for minority shares in a private corporation is the other shareholders of the corporation.

You may have options

If you're a sole proprietor or majority shareholder in a corporation, you're going to be able to decide for yourself whether to bring family members into the business — or whether to sell the business and pass its value on that way.

If you're bullish on keeping your business in the family, you may be interested to know you're in the minority of Canadian business owners. Experts who surveyed a sample of family-owned Canadian businesses with annual revenues of at least $1 million revealed that only one-third of owners thought it was important to keep the business in the family.

But if you're not afraid to buck a trend and you'd still like to hand down your business to your family, brace yourself for a bear market. Another survey, this one by the Family Firm Institute, an international organization that assists family businesses, showed that only about 30 percent of family-owned businesses survive into the second generation, 12 percent into the third generation, and 3 percent into the fourth generation and beyond. Of all family businesses in Canada, only 2 percent have passed through four generations or more. So even if nothing's stopping you from passing your business on to your children, your chances of creating a commercial dynasty are small.

So what's the plan here? You've got a choice. Should you try to keep the business in the family, or should you sell? In order to make your decision, you'll have to start thinking about the nature of your business, the abilities and interests of your children, and your own temperament.

Look at your business

The characteristics of your business itself may determine whether or not it can be passed successfully on to the next generation. If it can't, the recommendation is to sell. If you could use a little help pondering this matter, here are some points to consider:

- Must your business be operated by someone with special training or expertise? If you are a licensed professional or a skilled tradesperson, your business probably can't be carried on by a family member who isn't qualified in that trade or profession.
- Can your business get along without you or are *you* the business? Is your business based solely on your particular skills, talents, and/or personality? If that's the case, it may be that *no one,* inside or outside your family, can take it over successfully. It has value — income value — only as long as you're running it, and there may be no value to pass on.
- How much is your business worth as a going concern? Is it worth enough to pass it on to all of your children who are interested in sharing in it? In other words, will they all be able to earn a decent living from it, either right away or after they've used their skills to expand it? Or will they starve? If the business won't support them, you would be doing them a favour to sell it and pass on the proceeds instead.
- How much has your business gone up in value since you started it? Selling your interest in your business or transferring it to a family member other than your spouse could trigger a capital gain or loss. (See Chapter 2.) If your business is a corporation, note that a maximum lifetime capital gains deduction can be claimed by any individual. The 2007 federal budget increased this deduction from $500,000 to $750,000, effective March 19, 2007. At the time of publication this proposed change was not yet law, but it has been approved in the House of Commons. Specifically, this deduction is for qualifying small business corporation shares and is permitted under the *Income Tax Act.* If your business is a sole proprietorship or partnership, no deduction is available. Will you have enough other money and property (or life insurance) to pay the tax on any capital gain that pops up when you give your business to your children? If you don't, selling your business may be the only way you'll get the money needed to pay the tax due.

Look at your family (1): The advancers

Assume your business meets the requirements to be handed on to your children. Every family has its advancing and declining issues, and the character and talents of your family members will determine whether passing your business on to the next generation is wise or even possible.

First of all, is anyone in your family *with the talent and ability to be successful* interested in taking over your business? If your only child or all of your several children have the desire and the talent to carry on, you could be all set to start dynasty building.

Do none of your children have the talent to carry on (whether interested in doing so or not)? Again, you're all set — to sell to an outsider. Letting your children take over just to run the business into the ground is pointless. It will be best for them if you sell the business and give them the money to finance other enterprises they're better suited for.

But those two scenarios aren't the end of the possibilities. What if . . .

- You have several children, and they're all interested but only some are talented. Do you cause family strife by taking on some and rejecting the others? If you believe that taking on only some of your children will cause a lot of harm to your family, and you care more about your family than about your business, then consider a sale.
- You have several children with the interest and the talent (whether they represent all of your children or only some of them). Do they get along well enough with each other that it's safe to bring them all in? Have their dispute resolution skills improved since they fought as children over the TV remote and whose turn it was to walk the dog? If they can't get along well as people, they'll have trouble getting along as partners, and an enforced partnership is almost certainly doomed.
- You have interested, talented children who get along well with each other. But are they capable of working with and learning from you? Will they be willing to wait until you are ready to hand control over to them, or will they try to force you out of the business before you are ready?

One last (somewhat gloomy) thought here: If it's a commercial empire you have in mind, even if your children get along well enough to cooperate as partners themselves, they may have trouble cooperating when it comes time to choose among their own children as their successors. That's the stage at which the McCain family business came unglued. That old expression, "Shirtsleeves to shirtsleeves in three generations" exists for a reason.

Look at your family (2): The decliners

If you have more than one child and you decide (for various reasons, not restricted to those discussed above) to turn your business over to one or some of them rather than to all of them, what are you going to do about the children who've been left out of the business?

Your business has value. It may even be the most valuable thing you own. You may not care that you're not treating all your children equally in your estate plan by cutting some of them out of the business. But it's bound to cause trouble, and you may not want to increase your family's volatility (or turn your family into a hornet's nest). But then again, you may care very much about acting fairly toward everyone.

Certain solutions to the problem of an unequal distribution of your estate, short of selling the business to an outsider, can save you a lot of grief:

- You may have enough other money and property or enough life insurance that you'll be able to divide your estate equally among your children anyway.
- You may decide to make a gift of only part of the value of the business, and require your chosen successor to buy the rest of the business's value from you or your estate — so that you have enough money to leave equal shares to your other children. (Before you go for this solution, consider whether the business generates enough income for your child to be able to afford the purchase price you're asking. You don't want to sink your successor into debt.)
- You may decide to give ownership of the business to all of your children on the understanding that only one of your children will operate the business. In this case you have to consider whether the business is profitable enough to support several owners, and whether the silent partners are capable of actual silence.

Look at yourself

Now, what about you? Can you do whatever is necessary to ensure a smooth transfer of control of your company to your children? Are you a floor trader at heart, working for yourself alone? Or are you the kind of person who can give up control of your business before you die, if that's what it will take to make the transition successful? Ask yourself:

- Can you bring yourself to choose a successor at all?
- Are you truly willing to involve your children in the ownership and/or control of your business before you retire?
- Are you capable of working *with* and perhaps *for* your children, rather than always being the boss?

If you answered no to any of these questions, you're probably not a good candidate for founder of a dynasty. Neither was a "very foolish fond old man."

Timing is everything: When should you hand things over to your family?

If you're going to hand over ownership of your business to your family, when should you do it? Take a number of things into account:

- **When can you afford to retire from the business?** If you don't have other income and investments to live on, and if your successors won't make enough from the business to pay you for it while they run it, you may have no choice but to hang on to the business yourself until you die.

- **When can you afford the tax on the capital gain?** If your business has gone up in value, you may have to pay capital gains tax when you transfer ownership of the business. If you don't have sufficient other money and property to be able to pay the tax without having to liquidate the business, you may have to hold on to the business until you die. At that point, life insurance you've bought for the purpose will help your estate cover the tax on the capital gain.
- **Do you expect your business to continue to go up in value?** If so, you may want to consider some form of estate freeze fairly soon that involves transfer of ownership (although not necessarily control) away from you. (See Chapter 2 for more on estate freezes.) If you do an estate freeze on your business, you may or may not have to pay capital gains tax on the current value of the business. But either way, future increases in value will belong to your children and will not be taxable in your hands. Your children will not have to pay any tax on increases in value until they dispose of the business.

Even if you decide you can't afford to hand over ownership before you die, consider handing over control of your business — or at least partial control — while you're still alive. Bringing your family into the business while you're still around will increase their chances of successfully carrying on the business because

- They will have the opportunity to learn about the business from an expert — you.
- Your clients or customers will have an opportunity to get to know your children and transfer their trust and loyalty (now yours alone) to them.

Timing is everything: When should you sell?

If you are planning to sell your business, you want to sell it for the highest possible amount. So you want to sell it when it's most valuable. Is that when it's a going concern? Or when you're finished with business life — well, with life in general — and your executor may be selling off just the business's property?

Most businesses are worth more as a going concern than as a collection of assets. And usually your business will be worth even more as a going concern if you're still around. A business that's in business has *goodwill,* which can be loosely defined as the intangible value of the high likelihood customers will keep coming back. If you stick around for a while after a new owner takes over, the customers are more likely to do that. For another thing, you can offer a buyer your expertise by agreeing to stay on while the buyer learns the ropes and gets to know your customers.

Another reason to sell while you're alive: You can arrange to have the sale price paid to you in instalments spread out over several taxation years, and so reduce the tax payable on any capital gain. If you cling to your business until you die, you are deemed to have disposed of it at your death. Then your estate has to receive the full proceeds all at once and pay any taxes due in that same taxation year. This will come at a really bad time because you're deemed to have disposed of your non-business assets as well, and your estate will have to pay tax on any resulting capital gains. Just for fun, don't forget that everything in your RRSPs not left to your spouse will be considered income and be taxed as well.

Transferring or selling a sole proprietorship

A sole proprietorship is fairly easy (from a legal point of view) either to transfer or sell. The business is essentially the assets (property) the proprietor owns personally and uses to carry on the business. When the sole proprietor has decided what to do, then he or she can act right away.

Keeping it in the family

If you want to hand over your business to a family member during your lifetime, you'll have to legally transfer ownership of all the assets of the business. (You'll trigger a capital gain for yourself if your assets have gone up in value.)

If you want to hand over your business on your death, you will need a properly drafted will leaving the assets of the business to your chosen successor(s). (See Chapter 4 for more on wills.)

If you've decided on an estate freeze, you'll need to make extra plans. An estate freeze is a lot more complicated than simply handing over your assets during your lifetime or leaving them in your will. (See Chapter 2 for more on estate freezes.)

You'll probably want your successor to get not only the assets of the business but also all of the debts of the business. If you're giving your business away during your lifetime, you'll have to make some arrangements with your successor and your creditors for the payment of your business debts. If you're giving your business away in your will, your estate will be responsible for paying its debts. That could have the effect of reducing other family members' shares of your estate — so take this into account when you're making your estate plan.

Selling outside the family

Selling to an outsider is much the same as transferring to a family member — you transfer ownership of the assets used in your business to the purchaser and make arrangements for the payment of your business debts.

At the time of the sale, you'll want some tax advice about reducing the taxes payable on any capital gain you've triggered by the sale. For example, you may be able to arrange for the price to be paid to you in instalments spread out over several taxation years.

Selling a partnership

If you're a partner in a business, your best plan probably is to have your partners buy your interest when you retire or die. That means you need a partnership agreement that deals specifically with retirement and death.

If you have no partnership agreement or you have one but it doesn't deal with retirement and death issues, your partnership will simply dissolve when you leave or die (the exception is a *declared partnership* in Quebec). If you have a two-person partnership, it will dissolve when you leave or die whether or not you have a partnership agreement. After you reach the point of retirement or death, you (or your estate) will be at a disadvantage when it comes to negotiating a price for your interest in the partnership or your share of the partnership assets. That's because your partners aren't required to buy you out, and they may not have the money to buy you out anyway. And they have to agree before you can sell to an outsider — assuming you can find one who wants to join this partnership.

To prevent this financially unpleasant situation from coming to pass, you need a partnership agreement that deals with what happens when a partner wants to leave or retire or dies. And you need it now, before you're actually ready to leave or retire or die.

You'll need to speak to a business lawyer about this, but your agreement should have:

- A buy-out clause *or* a buy-sell clause. If one partner wants out, either the rest of the partners buy that partner out or (usually only in small firms) that partner buys out all the other partners. (If no one is willing to buy, then the partnership is dissolved.)
- A retirement clause. The other partners buy out a partner who wants to retire. The clause will say how the price of the buy-out is to be calculated (the buy-out money will probably have to be borrowed).
- A clause that requires the other partners to buy the interest of a partner who has died from the dead partner's estate.
- A clause that requires the partners to have life and disability insurance on each other. The insurance proceeds can help fund a buy-out triggered by the death or disability of a partner.

It's possible, but uncommon, to have a partnership agreement that allows partners to sell their partnership interest to an outsider if the other partners approve of the new partner.

Transferring or selling a corporation

To transfer or sell your ownership interest in a corporation, you have to transfer or sell shares in the corporation. That sounds easy enough, but it isn't always that easy in practice.

Keeping it in the family

If you are the only or the majority shareholder in your business corporation, you're free to transfer your shares to whomever you like. You don't need anyone's consent if you're the sole shareholder or the majority shareholder. So you'll simply sign the shares over to your family member while you're alive, or leave the shares in your will.

If you're just one of the shareholders and are not the majority shareholder, you'll need the consent of at least some of the other shareholders and/or the directors of the corporation to hand over your shares to anyone. If you want to be able to give or leave your shares to a family member, it is critical that you have a *shareholders' agreement* saying you can do that. You'll need to negotiate the agreement with your fellow shareholders before the time comes for you to make your dynasty-building move. The other shareholders may want their children to come into the business as well, so there could be interesting times ahead for the corporation.

Selling to an outsider

If you are the only shareholder or the majority shareholder, again you can do whatever you like with the corporation. You're free to sell it to the buyer of your choice. (Unhappy minority shareholders might have a right to complain to the court about what you're doing, however.) You can sell a business corporation either by selling all of the corporation's assets or by selling its shares.

Whether you choose an asset sale or a share sale will depend largely on the tax consequences for you — consult your lawyer and accountant before you start negotiating a deal with a buyer.

If you are not the only shareholder or the majority shareholder, for all practical purposes your market is limited to your fellow shareholders or the corporation. But if you want to sell to either you'll need to do some advance planning, because without a shareholders' agreement in place

- Neither the shareholders nor the corporation are automatically required to buy your shares.
- Neither the shareholders nor the corporation are required to offer a fair price for your shares.
- Even if the corporation and/or the shareholders want to buy your shares, they may not have enough money.

The upshot is, you want a shareholders' agreement that requires the other shareholders or the corporation to buy your shares from you or your estate and that says how the price is to be calculated. The agreement should also require the shareholders to be insured (life and disability insurance) so there will be money to fund a share purchase on the death or disability of a shareholder. (If you just leave and don't die, the shareholders or corporation will probably have to borrow money to pay for your shares.) You may also want the agreement to give you or your estate the right to terminate the corporation's existence, so you can get your share of the corporation's property if the other shareholders or the corporation can't buy your shares.

Chapter 4

Reading and Understanding a Will

In This Chapter

- Discovering that formal wills are not written in English
- Determining what a will says, in translation
- Investigating the rules about how a will is signed and witnessed

If you don't have a will, you can't put your estate plan into action. In fact, if you don't have a will, your estate could be in a real mess. A person who dies without a will is said to have died *intestate*. You can die intestate by never making a will at all, or by making a will that turns out to be invalid (because you are not legally capable of making a will or because your will is not properly signed and witnessed). If you die intestate, here are some of the consequences:

- Your property will be given away according to rules set by provincial law.
- There won't be an executor, carefully chosen by you, who will have the automatic right to look after your estate.
- Your estate may lose money while it is being administered.
- The property of your estate may not be given away in the form you'd like (even if it were going to the people you'd like).
- Your estate will probably end up paying more in taxes.
- If any of your beneficiaries are under the age of majority, any property that goes to them has to be managed by the provincial government.
- Your wishes about who will look after your children when you're gone may not be made known.

If you don't have a will, promise yourself you'll have one by next weekend. Any will is better than no will. It will be sad enough for those who care for you after you have gone. So please don't cause those people to have double the grief due to you leaving them in the state known as intestate.

If you do have a will but it's more than ten years old, get a new one. Even if you change nothing in your will but the date, your survivors will have a smoother time dealing with your estate.

So that you don't end up in a state of intestate (so to speak), this chapter moves estate planning from theory to practice. You find out why you need a will, examine a sample will, and discover what the heck each section of it means.

Get Ready, Get Set, Get Lost

Reading a standard will prepared by a lawyer is like turning on the hyperdrive and blasting out of the familiar solar system. It's very easy to get lost! But with a little training (from this chapter), you won't find yourself drifting helplessly and searching for a familiar landmark when you look for the first time (or the tenth time) at your own will.

A standard will can be very short or can go on for pages and pages. It is usually at least several pages long and contains a series of numbered paragraphs. Although every will is tailored to the needs of the individual, wills often follow a standard pattern. You can expect to find clauses that:

- Identify the *testator,* the person making the will (you).
- Revoke (cancel) all previous wills, to make it clear this will replaces any earlier will you made.
- Name the executor, the person who will administer your estate.
- Leave all of your property to your executor in trust. (Please remain calm and do not unbuckle the restraints of your zero-gravity chair, as ignition is imminent. This isn't a scam dreamed up between your lawyer and your executor to grab your estate. The executor, as the trustee of your estate, is given a kind of ownership of the property in the estate after you die but has to hand out the property according to the instructions in your will.)
- Tell the executor to pay all valid debts, claims, and taxes of the estate.
- Tell the executor to give your beneficiaries (people and/or charities you've chosen to receive gifts) whatever is left in the estate after the debts, claims, and taxes have been paid.
- Give the executor certain legal and financial powers to manage your estate — power to keep or sell property in the estate, to invest cash to borrow money, and to file your last tax return as well as your estate's tax return(s).
- Name someone to have custody of minor children, if you have any.

Taking a Close Look at a Will

In the rest of this chapter, you work through what a complete standard will may look like. The first thing you'll notice is that it is not written in English. It's mostly written in Englatin, with some medieval French thrown in. You'll also notice that it follows the simple rule, "Why use one word when three will do?" As well, when it comes to sentence length, enough is never enough, and punctuation is almost totally banned (especially if it may put a sentence out of its misery). After you review the will in all its glory, you can go through it paragraph by paragraph, translated into English, and figure out what's going on.

No one-size-fits-all will exists. Each person's will has to meet the needs and objectives of that particular person. So first, here are the details you need to know about this will's testator, John Robinson, and about his wishes.

John Robinson is married to Maureen Robinson. They have a grown-up daughter, Judy, and two younger children, Penny and Will. And who knows, they may have more children, depending on plot requirements and available alien technology.

John wants to leave his state-of-the-art atomic force microscope to his colleague, Dr. Zachary Smith; $10,000 to his daughter Judy; and $2,500 to the Alpha Prime Foundation to Save All Humanity Resident in Canada (a CRA–registered charity). He wants to leave everything else to his wife, if she is still alive when he dies. If his wife dies before he does, he wants to divide his estate among his children and wants each minor child's share of the estate to be held in trust until the child is 21 years old.

He wants his wife to be his executor if she is still alive when he dies. If his wife dies before he does, he wants his daughter Judy to be his executor. He wants his executor to have broad powers to deal with his estate and to be able to use her own judgment about what to do — because you never know when an intergalactic financial opportunity or disaster may occur.

Now that you've met John Robinson, have a look at Figure 4-1 to see what a sample will for him might look like. If you try reading it at all, your eyes will probably cross around Paragraph III(a), and the rest of the will will go by in the kind of blur you normally associate with space travel at warp speed. Then you'll slowly move in for a closer look at the sample will, hopefully making it comprehensible in a language spoken by humans.

THIS IS THE LAST WILL AND TESTAMENT of me, JOHN ROBINSON, of the City of Jupiter 2, in the Province of an Unknown Part of the Galaxy

I I REVOKE all former wills and other testamentary dispositions made by me

II I NOMINATE, CONSTITUTE, AND APPOINT my wife, MAUREEN ROBINSON, to be the executor and trustee of this my will, provided that if my said wife shall have predeceased me or shall survive me but die before the trusts hereof shall have terminated or shall refuse or be unable to act or to continue to act as such executor and trustee, then I nominate, constitute, and appoint my daughter, JUDY ROBINSON, to be the executor and trustee of this my will in the place and stead of my said wife I hereinafter refer to my executor and trustee for the time being as my "trustee "

III I GIVE, DEVISE, AND BEQUEATH all of my property of every nature and kind and wheresoever situate, including property over which I may have a general power of appointment, to my trustee upon the following trusts, namely:

(a) To pay out of the capital of my general estate my just debts, funeral and testamentary expenses, and all estate, inheritance, succession duties, or taxes whether imposed by or pursuant to the law of this or any other jurisdiction whatsoever that may be payable in connection with any property passing (or deemed to pass by any governing law) on my death or in connection with any insurance on my life, or in connection with any gift or benefit given or provided by me either in my lifetime or by survivorship or by this my will or any codicil hereto, and whether such taxes and duties be payable in respect of estates or interests which fall into possession at my death or at any subsequent time; and I authorize my trustee to commute or prepay any such taxes or duties

(b) To deliver to ZACHARY SMITH, if he survives me, my Atomic Force Microscope

(c) To pay to my daughter, JUDY ROBINSON, if she survives me, the sum of TEN THOUSAND DOLLARS ($10,000)

(d) To give to the Alpha Prime Foundation to Save All Humanity Resident in Canada, located in Ottawa, Ontario, Canada, the sum of TWO THOUSAND FIVE HUNDRED DOLLARS ($2,500) for its general purposes I declare that the receipt of the person who professes to be a treasurer or other proper officer for the time being of this charitable organization shall be a sufficient discharge to my trustee therefor

(e) To pay, transfer, and assign the residue of my estate to my wife, MAUREEN ROBINSON, if she survives me for a period of thirty days, for her own use absolutely

(f) If my said wife predeceases me or survives me but dies within a period of thirty days of the date of my death, to divide the residue of my estate into as many equal shares as there shall be children of mine then alive, and I declare that if any child of mine should then be dead and if any issue of such deceased child should then be living, such deceased child of mine shall be considered as alive for the purpose of such division

My trustee shall set aside one of such equal shares as a separate trust for each child of mine who shall be living at the division date and shall keep such share invested and the income and capital or so much thereof as my trustee in her uncontrolled discretion considers advisable shall be paid to or applied to the benefit of such child until he or she attains the age of twenty-one years when the capital of such share or the amount thereof remaining shall be paid or transferred to him or her, any income not so paid or applied in any year to be added to the capital and dealt with as part thereof If such child should die before attaining the age of twenty-one years, such share, or the amount thereof remaining, shall be held by my trustee in trust for the issue of such child who survive him or her in equal shares per stirpes If such child should leave no issue him or her surviving, such share or the amount thereof remaining shall be held by my trustee in trust for my issue alive at the death of such child in equal shares per stirpes

IV I AUTHORIZE my trustee to use her discretion in the realization of my estate, with power to sell, call in, and convert into money any part of my estate not consisting of money at such time or times, in

(i)

Figure 4-1: A sample will for John Robinson.

such manner and upon such terms, and either for credit or for part cash and part credit as she may in her absolute discretion decide upon, or to postpone such conversion of my estate or any part or parts thereof for such length of time as she may think best My trustee shall have a separate and substantive power to retain any of my investments or assets in the form existing at the date of my death at her absolute discretion without responsibility for loss to the intent that investments or assets so retained shall be deemed to be authorized investments for all purposes of this my will

V I DECLARE that my trustee when making investments for my estate shall not be limited to investments authorized by law for trustees but may make any investments which in her absolute discretion she considers advisable, and my trustee shall not be liable for any loss that may happen to my estate in connection with any such investment made by her in good faith

VI MY TRUSTEE may make any division of my estate or set aside or pay any share or interest therein, either wholly or in part, in the assets forming my estate at the time of my death or at the time of such division, setting aside or payment, and I expressly declare that my trustee shall in her absolute discretion fix the value of my estate or any part thereof for the purpose of making any such division, setting aside or payment, and her decision shall be final and binding upon all persons concerned

VII SUBJECT AS herein specifically provided, if any person other than a child of mine should become entitled to any share in my estate before attaining the age of majority the share of such person shall be held and kept invested by my trustee and the income and capital, or so much thereof as my trustee in her absolute discretion considers advisable, shall be used for the benefit of such person until he or she attains the age of majority

VIII I AUTHORIZE my trustee to make any payments for any person under the age of majority to a parent or guardian of such person or to anyone to whom she in her discretion deems it advisable to make such payments, whose receipt shall be a sufficient discharge to my trustee

IN WITNESS WHEREOF I have to this my last will and testament, written upon this and 1 preceding page, subscribed my name this 11th day of June, 20__

SIGNED by the testator, JOHN ROBINSON,)
as his last will, in the presence of us,)
both present at the same time, who at)
his request, in his presence and in the) _____
presence of each other have hereunto) John Robinson
subscribed our names as witnesses)

WITNESS:

Signature: _____

Name: _____

Address: _____

Occupation: _____

Signature: _____

Name: _____

Address: _____

Occupation: _____

Identification

THIS IS THE LAST WILL AND TESTAMENT of me, JOHN ROBINSON, of the City of Jupiter 2, in the Province of an Unknown Part of the Galaxy.

This part is easy. It identifies the document as a will and the testator as John Robinson. It also identifies his city and province of residence. Pat yourself on the back for understanding everything perfectly so far.

Revocation of other wills

I. I REVOKE all former wills and other testamentary dispositions made by me.

The making of a will generally cancels any previous wills. Clause I makes it clear the testator does intend to cancel them. "Other testamentary dispositions" would include a *codicil,* an addition to an existing will that revises some part of the will. (***Note:*** In the farthest western reaches of our galaxy, a codicil is a hallucinogenic fungus. It would be wise not to confuse the two.)

Naming the executor

II. I NOMINATE, CONSTITUTE, AND APPOINT my wife, MAUREEN ROBINSON, to be the executor and trustee of this my will, provided that if my said wife shall have predeceased me or shall survive me but die before the trusts hereof shall have terminated or shall refuse or be unable to act or to continue to act as such executor and trustee, then I nominate, constitute, and appoint my daughter, JUDY ROBINSON, to be the executor and trustee of this my will in the place and stead of my said wife. I hereinafter refer to my executor and trustee for the time being as my "trustee."

Clause II appoints John's wife, Maureen, to be his executor. If Maureen dies or is unwilling or unable to act as John's executor or to complete the executor's work, John appoints his daughter Judy to be executor. (For more information about choosing an executor and what an executor does, see Chapter 3.)

John named an alternate executor for Maureen (Judy), but has not named an alternate executor for Judy. (He was probably running out of trustworthy adults, and trust companies have not caught on much beyond the orbit of Pluto.) If Maureen dies and then Judy dies, Judy's executor will become John's executor.

After this clause, you may lose track of the executor and wonder if she has fallen into a black hole. She hasn't, she's just changed her name. This clause names the executor as both executor and trustee, and the executor is referred to as "the trustee" for the rest of the will. That's because the next clause sets up a trust for all of the property in John's estate, and the executor is the trustee who deals with the property.

Leaving property to the executor in trust

> *III. I GIVE, DEVISE, AND BEQUEATH all of my property of every nature and kind and wheresoever situate, including property over which I may have a general power of appointment, to my trustee upon the following trusts, namely:*

Clause III gives all of John Robinson's property to his executor, not for her own benefit but for the benefit of the people who will eventually receive the property under the will. These are the people to whom John's estate owes money, and the beneficiaries.

A "general power of appointment," in case you were wondering, is a very old-fashioned right over property that you rarely find in Canada anymore.

John's instructions to his trustee about what to do with the property in trust are set out in the lettered sub-paragraphs that follow this clause.

Payment of debts

> *(a) To pay out of the capital of my general estate my just debts, funeral and testamentary expenses, and all estate, inheritance, succession duties, or taxes whether imposed by or pursuant to the law of this or any other jurisdiction whatsoever that may be payable in connection with any property passing (or deemed to pass by any governing law) on my death or in connection with any insurance on my life, or in connection with any gift or benefit given or provided by me either in my lifetime or by survivorship or by this my will or any codicil hereto, and whether such taxes and duties be payable in respect of estates or interests which fall into possession at my death or at any subsequent time; and I authorize my trustee to commute or prepay any such taxes or duties.*

Paragraph (a) directs the executor (now of course known as the trustee) to pay all legitimate (valid) debts, claims, and taxes of John Robinson's estate, including the cost of his funeral. Most of the paragraph deals with the different ways taxes might become payable. The executor is given the right (by John, not by the Canada Revenue Agency) to use her judgment about the timing of tax payments — she can put off paying *(commute)* or pay in advance *(prepay)*.

Payment of debts and taxes is the executor's first responsibility. Nothing can be given to the beneficiaries until it is clear enough money is in the estate to pay the debts and taxes. If not enough money exists to cover them *and* the full amount of the gifts to the beneficiaries, the gifts to the beneficiaries will be reduced.

Distributing the remaining property to the beneficiaries

After the executor pays the debts and taxes of John's estate, she must give the remaining property to the beneficiaries according to John's instructions. First, she must give the specific gifts John made in his will. After the specific gifts are made, she must distribute the *residue.* The residue is what is left after debts, claims, taxes, and estate administration expenses have been paid and the specific gifts have been given out.

Specific gifts

John's will contains three specific gifts, one of personal property and two of cash.

> *(b) To deliver to ZACHARY SMITH, if he survives me, my Atomic Force Microscope.*

This gift of property is worded in a typical way. There will be a gift only if Zachary Smith is alive when John dies. If Dr. Smith dies before John, Smith's heirs are not entitled to the gift. The microscope will become part of the residue of John's estate and go to other beneficiaries of John's.

Even though paragraph (b) doesn't say so, there will also be a gift only if John owns the microscope when he dies. If he doesn't own it at the time of his death, Dr. Smith will get nothing because the will does not provide for an alternate gift to him.

> *(c) To pay to my daughter, JUDY ROBINSON, if she survives me, the sum of TEN THOUSAND DOLLARS ($10,000).*

This is a typical gift of cash to an individual. There will be a gift only if Judy is alive when John dies. If Judy dies before John, her heirs will not be entitled to take the gift. The cash will become part of the residue of John's estate.

And there will be a gift only if $10,000 is left in John's estate after his executor pays the estate's debts and gives Dr. Smith the microscope.

(d) To give to the Alpha Prime Foundation to Save All Humanity Resident in Canada, located in Ottawa, Ontario, Canada, the sum of TWO THOUSAND FIVE HUNDRED DOLLARS ($2,500) for its general purposes. I declare that the receipt of the person who professes to be a treasurer or other proper officer for the time being of this charitable organization shall be a sufficient discharge to my trustee therefor.

This is a typical gift of cash to a charity. Chapter 2 has a bit more discussion on gifting to charities.

In the second sentence of paragraph (d), John is saying the executor has done all that is expected of her if she gives the money to the charity and gets a receipt for it from someone who appears to be an officer of the charity. This paragraph is designed to protect the executor from liability if the person she pays the money to turns out to be the wrong person.

Gift of the residue

(e) To pay, transfer, and assign the residue of my estate to my wife, MAUREEN ROBINSON, if she survives me for a period of thirty days, for her own use absolutely.

John is leaving the residue of his estate (what's left after payment of his debts and taxes and the gifts to Dr. Smith, Judy, and the Alpha Prime Foundation) to his wife Maureen. "For her own use absolutely" means "no strings attached" — she can do whatever she likes with the property she receives. (An alternative would be to give her the use of the property for her lifetime and then give it to the children.) But she only gets the residue if she lives for at least 30 days after his death. If she dies before John dies or less than 30 days after John dies, she will not inherit. Now what's that all about?

Suppose John and Maureen were in a cosmic radiation accident together. Without paragraph (e), Maureen would inherit from John even if she outlived him by only 15 minutes. The residue of John's estate would go to Maureen, and then would immediately become part of Maureen's estate and would be disposed of according to the provisions in *her* will. So John's property would be given to the people named by Maureen, not by John! Even if John and Maureen both name the same beneficiaries (as husbands and wives very often do), the property would have to pass through first John's estate and then Maureen's estate. That would result in extra work and expense.

Thirty days is the standard time period used in wills. The number 30 carries no magic nowadays, but it was probably once considered a reasonable length of time to wait to see whether the second of two people who were injured or who sickened at the same time was going to live or die.

Alternative gift of the residue

> *(f) If my said wife predeceases me or survives me but dies within a period of thirty days of the date of my death, to divide the residue of my estate into as many equal shares as there shall be children of mine then alive, and I declare that if any child of mine should then be dead and if any issue of such deceased child should then be living, such deceased child of mine shall be considered as alive for the purpose of such division.*

What happens if Maureen Robinson dies before John does? Who gets the residue of the estate then? Paragraph (f) gives the answer, and it's an eyeful.

If Maureen dies before or within 30 days after John dies, John's estate is to be divided equally among his children. If John's children all survive him, and John has no other children by that point, then each of the three children will get one-third of the residue.

Then the next question is: What happens if a child also dies before John does? After all, some days an evil plasma creature is lurking behind every rock.

When John was considering how to pass his estate on to his family, he had to think about whether the share of a child who died before him would simply go to his surviving children or whether it would go to any children his deceased child had. This paragraph shows that John ended up deciding to divide a deceased child's share among that child's own children.

Here's an example of how this paragraph might work itself out, given the following situation:

> *John dies, as the result of an unfortunate misunderstanding with a native of the planet Zifpox. At the time of his death, Maureen is already dead (unexpected meteorite shower, no shower cap) as is Judy (the espresso on the planet Tryffl is unbelievably strong). Penny and Will, John's two other children, are both in their 20s. Will has a son, Robby. Judy is survived by her two daughters, Blawp and Spingo.*

The residue of John's estate would be distributed like this:

- Penny will receive one-third of the residue.
- Will will receive one-third of the residue (and his son will receive nothing).
- Blawp and Spingo will receive Judy's one-third share and it will be split equally between them, so each of John's granddaughters will receive one-sixth of the residue.

Trust for children under the age of 21

> *(f)* continued *My trustee shall set aside one of such equal shares as a separate trust for each child of mine who shall be living at the division date and shall keep such share invested and the income and capital or so much thereof as my trustee in her uncontrolled discretion considers advisable shall be paid to or applied to the benefit of such child until he or she attains the age of twenty-one years when the capital of such share or the amount thereof remaining shall be paid or transferred to him or her, any income not so paid or applied in any year to be added to the capital and dealt with as part thereof. If such child should die before attaining the age of twenty-one years, such share, or the amount thereof remaining, shall be held by my trustee in trust for the issue of such child who survive him or her in equal shares per stirpes. If such child should leave no issue him or her surviving, such share or the amount thereof remaining shall be held by my trustee in trust for my issue alive at the death of such child in equal shares per stirpes.*

The paragraphs are getting worse. It may be time to turn on the neutron shields for protection.

The rest of paragraph (f), which should not be approached without full anti-particle gear, tells John's executor what to do if any of John's children or grandchildren are under the age of majority (18 or 19, depending on the province or solar system) when John dies. Remember that a minor child cannot receive property directly. In Canada, if no trustee is named, then the provincial public trustee is supposed to look after a minor child's inheritance.

John instructs that the share of any minor child (or grandchild), including any interest earned on the share, is to be held in a trust set up specifically for the child, with John's executor as trustee. The share, plus interest, is to be turned over to the child when he or she turns 21. John could have instructed his executor to turn over the child's share as soon as the child reached the age of majority. However, he thought that any child would be better able to handle the inheritance at a slightly older age. And when you factor in light-speed travel, it could take John's executor the additional two or three years just to figure out how old everyone is anyway.

Until the child turns 21, John instructs his executor to use her own judgment about how much of the money to give to or spend on the child.

Finally, if a child dies before reaching the age of 21, that child's share will be divided among his or her children, if any. If the child has no children, then his or her share will be divided among John's other surviving children. If one of John's children has died (under 21) but has produced children, then the share that would have gone to John's child will be divided among those children. If you're wondering where all of this comes from . . . because frankly

you don't see it there . . . part of what is said is an expansion of the two little words "per stirpes." This Latin phrase, meaning "through the descendants," says that if one of your children dies before you, your deceased child's children will get their parent's share, divided up among them.

Executor's powers

From this point on, the will mainly natters about giving the executor powers to deal with the estate. These include such things as the power to keep property of the estate in its current form instead of turning it into cash, the power to invest the estate's cash as the executor thinks best, the power to borrow money on behalf of the estate, and the power to buy property from the estate.

Turning the estate's property into cash

> *IV. I AUTHORIZE my trustee to use her discretion in the realization of my estate, with power to sell, call in, and convert into money any part of my estate not consisting of money at such time or times, in such manner and upon such terms, and either for credit or for part cash and part credit as she may in her absolute discretion decide upon, or to postpone such conversion of my estate or any part or parts thereof for such length of time as she may think best. My trustee shall have a separate and substantive power to retain any of my investments or assets in the form existing at the date of my death at her absolute discretion without responsibility for loss to the intent that investments or assets so retained shall be deemed to be authorized investments for all purposes of this my will.*

In clause IV, John gives his executor the power to keep any of the property of the estate in the form it's in when John dies, instead of selling it for cash. He also gives the power to delay turning property of the estate into cash. Under provincial law, an executor must turn all of the property of the estate into cash as quickly as possible — unless the will contains the powers given here.

Investments

> *V. I DECLARE that my trustee when making investments for my estate shall not be limited to investments authorized by law for trustees but may make any investments which in her absolute discretion she considers advisable, and my trustee shall not be liable for any loss that may happen to my estate in connection with any such investment made by her in good faith.*

In clause V, John has given his executor very broad powers to decide how to invest any cash in the estate. Instead of restricting her to the very safe investments permitted under provincial trust legislation, John is allowing his executor to invest in any type of investment she thinks will be good. (This is wise,

because provincial legislation has never seen the Intergalactic Stock Exchange during a trading session. It's true that you can easily lose your shirt and three of your five eyes, but, on the other hand, investors have been known to triple their pseudopod holdings in a single 20-second "trade blast.") John has also given his executor absolution: As long as she makes her investment decisions honestly, she will not be financially responsible to the beneficiaries if any of the investments lose money.

Distribution in kind

> *VI. MY TRUSTEE may make any division of my estate or set aside or pay any share or interest therein, either wholly or in part, in the assets forming my estate at the time of my death or at the time of such division, setting aside or payment, and I expressly declare that my trustee shall in her absolute discretion fix the value of my estate or any part thereof for the purpose of making any such division, setting aside or payment, and her decision shall be final and binding upon all persons concerned.*

If it turns out that more than one beneficiary will share in the residue of the estate (which will happen if Maureen dies before or within 30 days of John's death), John's executor will have to divide the residue of the estate into the correct number of shares. Under this will, the shares have to be of equal value (from paragraph III(f)).

John's estate may include some cash (in various currencies), some stocks, some rocks (picked up en route), his residence/vehicle, furniture, extraterrestrial art objects, and household goods. The only totally fair way to distribute the estate in equal shares would be to sell everything and split the cash. But, as with most estates, some items the beneficiaries would like to keep in the family. John, in clause VI, says that the executor can use her own judgment to decide to distribute some or all of the residue in its existing form. She'll be able to give each beneficiary a combination of cash and other property as long as the value of each beneficiary's share amounts to the correct percentage of the total value of the residue. If the beneficiaries can't agree on the value of individual pieces of property, the executor may have to get a professional valuation.

Dealing with minors

John's will contains two more clauses to help his executor deal with beneficiaries who are minors.

> *VII. SUBJECT AS herein specifically provided, if any person other than a child of mine should become entitled to any share in my estate before attaining the age of majority, the share of such person shall be held and kept invested by my trustee and the income and capital, or so much thereof as my trustee in her absolute discretion considers advisable, shall be used for the benefit of such person until he or she attains the age of majority.*

VIII. I AUTHORIZE my trustee to make any payments for any person under the age of majority to a parent or guardian of such person or to anyone to whom she in her discretion deems it advisable to make such payments, whose receipt shall be a sufficient discharge to my trustee.

Clause VII sets up a trust for anyone who may end up inheriting property under John's will while still a minor, but who is not already covered by the trust that looks after John's children and grandchildren. This is the ultimate "what-if?" clause because it addresses the possibility that when John dies his wife is dead and all of his children are dead without having left any grandchildren. John has not said where he wants his estate to go if that happens. As a result, his estate would be divided under provincial intestacy laws and might eventually reach a distant relative under the age of majority. If he has no relative, his estate will *escheat to the Crown* (become the property of the provincial government). If the estate escheats, this trust clause will be totally unnecessary — except on a small planet circling the star Tau Ceti, where the government is formed by citizens in the larval phase of development.

Clause VIII talks about the mechanics of making payments on behalf of beneficiaries who are minors. Because payments cannot be made directly to a minor, this clause gives the executor authority to make the payment to the minor's parent or guardian or to anyone else whom the executor considers suitable (for example, a school requiring payment of tuition fees, or Rigellian space pirates holding the minor hostage).

Signing provisions

IN WITNESS WHEREOF I have to this my last will and testament, written upon this and 1 preceding page, subscribed my name this 11th day of June, 20__.

SIGNED by the testator, JOHN ROBINSON, as his last will, in the presence of us, both present at the same time, who at his request, in his presence and in the presence of each other have hereunto subscribed our names as witnesses.

_____
John Robinson

WITNESS:

Signature: _____

Name: _____

Address: _____

Occupation: _____

Signature: _____

Name: _____

Address: _____

Occupation: _____

This final clause says how many pages long the will is. That's so nobody will be able to slip in an extra page after John has signed (yes, some people would tamper with a will).

The clause also says the date on which John signed the will. It is important to include the date, because a new will revokes all wills that John made earlier. Without dates, it will be impossible to know which will came first if John has more than one signed will.

Beside the place for John's signature is a strange blather about how the will was signed with everyone in everyone else's presence. It almost sounds like the testator and witnesses are a troupe of contortionists. It's actually a description of the proper signing procedure for a will.

Chapter 5

Power of Attorney and Your Living Will

In This Chapter

- Understanding how your property will be managed if you become disabled
- Discovering what a power of attorney is and what it does
- Creating a power of attorney
- Preparing a living will to allow another person to give consent on your behalf

You've got an estate (or you're in the process of creating one), and that means you have all kinds of affairs to transact. You work to produce income, you make investments, you buy and sell property, you take out insurance, and you make a will. What would happen to you (and your estate) if you were no longer able to rush around attending to your affairs because you were physically or mentally disabled?

People may be disabled for a period of time — in some cases for years — before they die. None of us likes to confront this scenario. For some people, disability is worse to face than dying. While you're in the process of planning how to care for your family and friends after you die, also make plans to care for yourself and them if you become disabled.

This chapter tells you why you need documents (a *power of attorney* and a *living will*) that allow someone of your choice to manage your finances and make decisions about your medical care if you become disabled before you die.

Power of Attorney: The Solution to Your Management Problems

A person is considered to be mentally incapable of making legal and financial decisions when he or she is not able to understand information relevant to making a decision, or is not able to appreciate what is likely to happen as a result of making the decision.

If you become mentally incapable of looking after your own affairs, you won't legally be able to do a surprising number of things. You won't be able to enter into contracts — and that will cut off your personal ability, for example, to

- Buy or sell investments
- Buy insurance
- Buy or sell real estate
- Buy or sell big-ticket items like a car
- Open a bank account or rent a safety-deposit box
- Take out a mortgage or a credit card
- Rent an apartment or make arrangements to go into a seniors' residence or a nursing home

They'll probably still take your cash down at the grocery store or pharmacy, and your bank may let you withdraw small amounts of money at reasonable intervals. But many merchants and almost all banks will get very nervous if you don't appear to be mentally coherent and you want to do something involving even a moderately large sum of money.

Other people you want to deal with may well go along with you too, if you don't look too glassy-eyed or talk too strangely (this is especially true if you transact business by mail or e-mail). However, two problems occur with this:

- You may, in your vacantness, want to enter into a contract that is harmful to you, or the other party to the contract may want to take advantage of your state of mind to defraud you.
- Even if the contract is perfectly fair, it can be challenged and set aside if someone realizes you were not mentally competent when you entered into it.

If you are mentally incapable, you will need someone else to conduct your legal and financial affairs for you all the time. If you are physically disabled, you may need someone else to conduct your legal and financial affairs for you only some of the time. In order to give someone else the ability to look after your affairs, you need to prepare a power of attorney. A power of attorney is a document that gives another person authority to handle legal and/or financial affairs of the person who signs the document.

Before going any further, take a look at this important vocabulary section. A power of attorney isn't known as a power of attorney in every province. This chapter uses the term power of attorney throughout, but, depending on the province, it may be known as a *power of attorney for personal property,* a *power of attorney for financial decisions,* a *mandate,* or a *representation agreement.* Similarly, this chapter refers to the person who makes and signs the power of attorney as the *principal,* although, depending on the province, this

person might also be known as the *donor* or the *grantor.* Finally, this chapter refers to the person chosen by the principal to handle affairs as the *attorney,* although — again depending on the province — this person might be known as the *attorney in fact,* the *agent,* the *donee,* the *mandatary,* or the *representative.*

Got it together now? The principal wants another person to look after the principal's legal and/or financial affairs, so the principal signs a power of attorney document appointing the person of his or her choice to be the attorney.

A power of attorney must be created when you are mentally capable. To be considered mentally capable of creating the power of attorney, you must be capable of knowing the value and kind of property you own and of understanding the powers you are giving to another person.

Powers of Attorney Come in Different Models

A power of attorney is quite flexible in its use. You don't have to be mentally or physically incapable to want one, you just have to want someone else to look after a legal or financial matter for you.

Examples, anyone? You can create a power of attorney that gives your accountant the power to handle all your affairs for a short period while you're out of the country and out of reach, or one that gives your daughter the authority to sell your cottage, or one that gives your son the authority to instruct your lawyer what to do in a lawsuit you've started, or one that gives your nephew the authority to make deposits to and withdrawals from your bank account. You can also create a power of attorney that gives a relative, friend, or professional adviser the power to look after all your affairs for the rest of your life.

A power of attorney has no flexibility in one respect, though: It ends as soon as the principal dies. It cannot take the place of a will, and it cannot override the provisions of a will. And an attorney cannot make a will on behalf of the principal.

Enduring or continuing power of attorney

An ordinary power of attorney is valid only as long as the principal is mentally competent. It automatically ends when the principal becomes mentally incompetent. For many people, of course, this is exactly the point at which they want the power of attorney to come into play.

This would be a much shorter chapter if there were no answer to this problem. Luckily, an answer does exist, and unluckily, this chapter is rather long. The answer is the *enduring* or *continuing* power of attorney. It is intended to continue in effect even after the principal becomes mentally incompetent. What's needed to turn an ordinary power of attorney into an enduring power of attorney is a specific statement in the power of attorney document that the power of attorney is intended to continue after the principal becomes mentally incompetent.

General or specific power of attorney

A power of attorney can be *general* or *specific*.

A general power of attorney gives the attorney power to make many or all financial and legal decisions on the principal's behalf. In most provinces, a general power of attorney gives the attorney authority to make any financial or legal decision the principal could make, and to do any financial or legal act the principal could do — except prepare or change the principal's will. The principal can impose limitations on the attorney's power when the document is prepared. But if the principal does not do so, the attorney has complete power to manage the principal's affairs. That includes, for example, receiving money and paying bills; opening and closing bank accounts; making bank deposits and withdrawals; making and cashing in investments; buying, mortgaging, and selling property; and hiring and firing workers (such as caregivers) for the principal.

A specific power of attorney gives the attorney power to carry out the transactions mentioned in the document. For example, it could allow the attorney to do personal banking, or to deal with stated sources of income such as investment income and dividends, or to carry out a particular activity such as selling a vacation property.

In Quebec, the situation is somewhat different. A power of attorney (called a *mandate*) automatically gives the attorney (called the *mandatary*) only the authority to make decisions and take actions necessary to preserve the principal's property, and it strictly limits the way in which the attorney can invest the principal's money. In addition, the attorney must get a court order to sell any of the principal's property. A Quebec power of attorney document must give the attorney "full administrative powers" in order to create a general power of attorney like that discussed above.

Banks have specific power of attorney documents for banking matters. You can usually get a form at your local branch, and, if you want to make a specific power of attorney only for banking, you don't need to go anywhere else to get a power of attorney. In fact, even if you have a general power of

attorney prepared by your lawyer, your bank may insist it needs a power of attorney for banking in its own form. You (or your attorney armed with a general power of attorney) may have an uphill climb to convince the bank employees that a general power of attorney includes a banking power of attorney.

If your bank refuses to accept the general power of attorney and insists on its own banking power of attorney, have the bank's form checked over by a lawyer before you sign it to make sure it doesn't cancel the general power of attorney.

Because it may be too late for you to sign a banking power of attorney by the time your general power of attorney is needed, have a discussion with the manager of your bank branch at the time you're having a general power of attorney prepared. Ask whether the general power of attorney will be acceptable. If it looks like the bank is going to be stubborn, take the bank's form for the banking power of attorney to your lawyer for review.

Investment dealers also have their own documents that might be useful. Your investment adviser might suggest the use of a "trading authorization," which can come with or without the right to withdraw cash from your investment portfolio.

What's in a power of attorney?

The power of attorney document differs from province to province. In most provinces, though, a power of attorney document usually

- **Names the attorney(s).** If more than one attorney is being appointed, the document should say whether the attorneys may make decisions alone or whether they must agree on all decisions. Sometimes, a power of attorney also names a substitute attorney who takes over if the original attorney is unable or unwilling to carry out the required duties.
- **Cancels previously made powers of attorney.** If an earlier power of attorney is in effect and the principal wants it to continue in effect, the later document must make that clear. (It's this cancelling clause in the banking power of attorney that can lead to trouble if you've already got a general power of attorney.)
- **Sets out the powers the attorney is to have.** The attorney can be given all powers the principal has, or any part of the principal's powers — such as the power to carry out certain types of transactions (for example, banking) or the power to deal with certain types of property (for example, investments or real estate).

- **Indicates whether or not the power of attorney remains in effect after the principal becomes mentally incompetent.** If the document says nothing about this, then it ends when the principal becomes mentally incompetent. If it is meant to continue in effect, the document must say so in the words required by the law of the province in which the power of attorney is to be used.
- **States when the power of attorney comes into effect.** A power of attorney can come into effect immediately or at some time in the future. In some provinces it comes into effect as soon as it has been signed and witnessed. (To prevent the attorney from acting before the principal is ready to hand over the reins, the principal can have a third person — say, the principal's lawyer — hold on to the document until the principal becomes mentally incapable.) In other provinces, the principal can decide when it will come into effect — on a specified date or on the happening of a specified event (usually the mental incapacity of the principal).

  If the power of attorney is to come into effect when the principal becomes mentally incapable, in some provinces the power of attorney document can say how it's to be decided that the principal has become incapable (for example, by the opinion of the principal's doctor or lawyer). If the document doesn't say anything about how to decide, then the provincial statute governing powers of attorney applies. In some provinces, the statute says two doctors must agree the principal is incapable. In other provinces, the statute says a court must decide.
- **Says whether the attorney is to be paid.** In most provinces, the attorney is not entitled to be paid unless the power of attorney says so. If the attorney is to be paid, the document may set out the amount or the provincial government may set the rate.
- **Makes conditions about how the attorney is to exercise his or her powers.** The document can say the attorney has to invest in certain types of investments, or consult with or report to the principal's family members or financial advisers, or keep financial records in a certain form.

What's Involved in Preparing a Power of Attorney?

The main thing involved in preparing a power of attorney is a visit to your lawyer (or, in Quebec, a notary).

No legal requirement exists that a lawyer has to prepare the power of attorney document, however. It's perfectly legal for a person to write out his or her own version, or fill out a pre-printed form. Several provincial Public Trustee offices can provide you with basic power of attorney kits free of charge.

However, the strongest recommendation is that you *not* go the do-it-yourself route. A power of attorney is much like a will — special rules exist about who can be an attorney and who can be a witness, and it also takes some legal knowledge to know what to put in the document and what to leave out. The following sections include some of the things that can go wrong for do-it-yourselfers.

The attorney

For the most part, choosing an attorney is not difficult. The attorney can be anyone who has reached the age of majority (18 or 19, depending on the province) and is mentally competent. Alternatively, the attorney can be a financial institution (usually a trust company).

Choose an attorney you trust and who you think would make the same kinds of decisions about your financial matters as you would make.

However, some traps can be waiting for the principal who doesn't get legal advice and assistance:

- In some provinces, an attorney who is the spouse of the principal may run into trouble if he or she later tries to mortgage, sell, or otherwise transfer the family residence. Under the family law statutes in some provinces, *both* spouses must consent to such a transaction. One spouse won't be able to use a power of attorney to give the other spouse's consent. (That's to make sure that, for example, a devoted wife is not using the power of attorney to transfer or mortgage the family residence out from under her adored husband.) So it may turn out, in your province, that your spouse is not the best person to be your attorney if your family home may have to be sold or mortgaged.
- If the principal wants to name more than one attorney, the principal has to state in the document whether each attorney can act alone or whether the attorneys must act together. If you don't say anything, they must act together.
- The principal may forget to name a substitute attorney in case the first choice is unwilling or unable to take on or continue the job.

The powers

A principal may well find it useful to have the help of a lawyer to give the attorney the proper powers. A do-it-yourself principal may make mistakes because:

- For the power of attorney to remain valid after the principal becomes mentally incompetent, specific wording must be in the document. If the required wording isn't used, the power of attorney may end just when it will be needed.
- If the principal wants to maintain an earlier power of attorney in effect (for example, a general power of attorney), a later power of attorney (for example, a banking power of attorney) must not contain a *revocation* clause that cancels the earlier one.
- If the principal wants to limit the attorney's powers in some way, or have the attorney show financial records to someone for review, that has to be dealt with specifically in the document.
- If the power of attorney is going to be used in connection with real estate, special wording may be required, as well as special signing procedures. In some provinces, the people witnessing the signing of the power of attorney may then have to swear an oath before a commissioner or notary public that they are the witnesses.
- If the principal has property in another province, one power of attorney may not be enough — a second power of attorney, valid in the other province, may have to be prepared.

The process

Getting the details of the power of attorney right is just as important as getting the right words in the document. A lawyer will make sure all the legal requirements for properly giving a power of attorney are met.

The principal must be in the right state

A lawyer will make sure the principal has reached the age of majority (easy) and is mentally competent to give a power of attorney (harder). Your lawyer won't let you sign a power of attorney document if you're mentally incompetent — there wouldn't be much point, because it wouldn't be valid if you sign it while incompetent. If your lawyer has doubts about you, he or she may even refer you to a doctor for an examination before agreeing to assist you in creating a power of attorney. This is a safeguard to make sure you know what you're doing when you give another person power over your financial affairs.

If someone later questions whether you were mentally competent when you signed the document, your lawyer will be able to give evidence you were. Why would someone challenge your mental competence at the time you signed? Because that person doesn't like the attorney you chose or the

decisions the attorney is making. If that person could prove to a court you were not mentally competent when you made the power of attorney, the power of attorney would be declared invalid from the beginning. A challenge is much less likely to occur if you had a lawyer help you prepare and sign the document, because a lawyer wouldn't ordinarily let you sign if you weren't right in the head.

The document must be signed and witnessed

A power of attorney has to be properly signed and witnessed, just as a will does. In most provinces, two witnesses must be present when the principal signs the document, and then the witnesses must also sign the document. The principal and the witnesses must all be present together to watch each other sign. (In some provinces, only one witness is required.) In some provinces, the witnesses may have to swear before a commissioner or a notary public that they are the witnesses.

The purpose of these rules is to make sure no one is forging the principal's name on the power of attorney, or sneakily getting the principal to give a power of attorney without knowing it, or forcing the principal to give the power of attorney against his or her will.

The witnesses must be eligible

Anyone who witnesses the signing of a power of attorney has to be eligible to be a witness. In almost all provinces, the witnesses must not be the attorney, the attorney's spouse, the principal's spouse, or the principal's child. Further, in some provinces only specified people such as judges, justices of the peace, lawyers, and doctors can act as witnesses.

The purpose of this rule is to make sure the witnesses don't have their own stake in creating the power of attorney. Independent witnesses presumably won't help anyone to forge a power of attorney or force the principal to sign a document against his or her will.

The attorney needs to know when it's time to take over

Finally, the attorney may need a lawyer's help to decide when the power of attorney can be used.

In provinces where the power of attorney comes into effect as soon as it is signed, the principal may want to instruct his or her lawyer to hold the power of attorney document and not give it to the attorney until the principal is mentally incapable. Then the attorney needs to know when to call up the lawyer and ask for the document. Discuss this matter with your lawyer.

In provinces where the power of attorney can come into effect when a particular event happens, the principal may state the event is mental incapacity. Again, the attorney may need to talk to a lawyer to decide whether the event has happened. The principal may even have stipulated that his or her lawyer should decide when it has happened (the usual alternative is to have the principal's doctor decide).

If the power of attorney is intended to come into effect when the principal becomes mentally incompetent and the document says nothing about how it's to be determined the principal is incompetent, the attorney may need a lawyer's assistance to find out what the provincial law says about determining incompetence. In some provinces two doctors are needed to give evidence; in others a court has to review the evidence and make a decision.

Making Your Wishes Known through a Living Will

The preceding section told you what to do so that your legal and financial affairs will be properly managed if you become unable to look after them yourself. However, if you can't look after your affairs, you probably can't look after yourself either. So who's going to look after you?

Although no such thing as universal legal and financial care exists in Canada, we do have such a thing as universal health care — at least for now! If you need to be looked after physically, you will be. If you need to be treated in a hospital, you'll be admitted to a hospital and treated — if a bed can be found for you. If you need to live in a nursing home, a space will be found for you after you get to the top of the waiting list. If you need home care, health care workers will come (although perhaps only eventually and occasionally).

So you don't really have to worry about making plans to get access to health care. Or, at any rate, no point exists in worrying. The thing you have to worry about is telling health care workers what you want. If you're sick or injured or dying, you may not be physically or mentally capable of telling anyone your wishes. When that time comes it may turn out you don't care what happens to you. But you probably care now — so now's the time to make your arrangements for a second-in-command who'll speak for you and tell everyone what you would say if you could.

If you're conscious and mentally capable, you make your wishes about medical treatment known by telling your doctor and/or family what you want. If you can't speak, you may have to write your wishes. If you can't speak or write, you may have to talk with your eyes.

If you're not fully conscious or not mentally capable, the way to make your wishes known is by having prepared a living will while you *were* conscious and capable. A living will lets an earlier, mentally capable, version of yourself speak through another person when the later version of you can't.

A living will can do two things:

- It can appoint someone to make health care decisions for you.
- It can tell the appointed decision maker what decisions you would like made.

In some provinces, a living will is intended to deal with medical treatment only. In others, it can also deal with personal care decisions about things such as housing, food, hygiene, clothing, or safety. You can find out more about living wills in your province from your lawyer, provincial law society, or provincial government.

A living will comes into effect only when you're not mentally capable of giving consent to or refusing medical treatment. In most provinces, living wills are legally recognized and the instructions in a living will must be followed. They override the wishes of a patient's family, in the same way the wishes of a mentally competent patient override the wishes of the patient's family. Even in provinces that haven't yet legally recognized living wills, the instructions will quite probably be followed too.

Almost every province has a different name for a living will. Depending on the province, the living will may be called a personal directive, a representation agreement, a health care directive, a power of attorney for personal care, a mandate, a directive, or an authorization. Also depending on the province, the appointed decision maker may be called an attorney for personal care, a proxy, an agent, a representative, a substitute decision maker, or a mandatary. This chapter refers to a living will and a substitute decision maker.

What does a living will say?

The living will form is different in different provinces, but generally you'll find the form covers several standard points.

It names the person who will speak for you

Some people appoint just one substitute decision maker to make decisions on their behalf. Others appoint two or more decision makers, usually to make sure someone will be available when needed rather than to create a safeguard against one person making the wrong decision. If you appoint more than one substitute decision maker but want one person to be able to act

alone if a decision has to be made quickly, your living will should say that any substitute decision maker can make a decision individually. But if you want group decisions in case they're safer, the living will should say the substitute decision makers must agree on all decisions.

Some people appoint a backup substitute decision maker in case the original substitute decision maker can't or won't act. This is probably wise, because you can't know what the future holds for your substitute decision maker any more than you can know what it holds for you.

See the section "Not everyone is eligible to be a substitute decision maker" in this chapter to find out who is eligible to act as your substitute decision maker.

It may cancel a previous living will

When you make a living will and name a substitute decision maker and give instructions about your health care, you normally want to revoke or cancel any previous living will you made. After all, you're making a new one because you've changed your mind about what you want done or whom you want to make decisions on your behalf.

It may list what health care decisions can be made

If provincial law allows a variety of decisions to be made by a substitute decision maker, a living will could give power to make all health care decisions, or (for example) power only to make decisions about medical treatment or power only to make decisions about food, safety, and hygiene.

It gives instructions about health care treatment

If you live in a province that allows you to give a substitute decision maker the power to make decisions about different aspects of your health care, you could give a variety of instructions. You could say, for example, that if possible you would prefer to be cared for at home instead of in a hospital or nursing home. You could say that you'd like to be cared for in your daughter's home rather than your son's. You could say that you want to be bathed daily, and that you want to be dressed instead of being left in pyjamas. You could say that if you develop a tendency to wander and get lost you would prefer to have a caregiver with you at all times rather than being restrained in a locked area or a chair or bed with straps. You can give instructions about anything that concerns you or occurs to you. Whether it will be possible to carry out your instructions when the time comes is a question for another day.

The instructions you give about medical treatment are a different matter. They tend to be geared less toward everyday life and more toward the question of how long you want to live and in what state. Your substitute decision maker is not going to have a lot of trouble deciding to consent to routine maintenance for you. You don't need to sweat over giving instructions to have your blood pressure taken by the nurse in a nursing home.

Your instructions to the substitute decision maker about medical treatment could be very general — for example, you could instruct that you don't want any treatment that won't cure you, or that won't improve your quality of life if it prolongs your life.

Or your instructions could be more specific — for example, that you do not want to be put on a ventilator or given CPR if you are in a permanent coma or vegetative state and suffer respiratory failure or heart failure. In fact, your instructions can be even more specific than that. You could run down a list of injuries and diseases and state in each case what treatment you would or would not consent to. That might be kind of a fun thing to do on a rainy afternoon.

If you're specific in your instructions, you'd better say how much discretion your substitute decision maker has to make a different decision. You might not want to miss out on a new medical treatment that could have you back on your feet in no time flat, or you might prefer not to be given experimental treatment that would be unpleasant and would provide little permanent benefit.

If you actually have a particular disease or condition when you make your living will, make sure you and your substitute decision maker understand how the disease or condition is likely to progress, what the available treatment options are, what they involve, and whether they're likely to be successful. Talk to your doctor, or do research in a library or on the Internet.

It may give instructions about organ and tissue donation

Your instructions to your substitute decision maker can also include your wishes for organ and tissue donation. Know, however, that if you give advance consent to organ or tissue donation, and members of your family are opposed when the time comes, the hospital will probably not accept your donation.

How do you make a living will?

You can fill out a do-it-yourself form to make a living will. You don't have to have a lawyer (or, in Quebec, a notary). However, having a living will prepared by a lawyer is best. A lawyer will act as an objective person who can help you decide what instructions you want to leave and who can help you choose the best person to be the substitute decision maker. In addition, a lawyer won't forget to use any special language the province wants in a living will.

A lawyer will also make sure that you are legally capable of making a living will, that your substitute decision maker is legally eligible to act, and that any special formalities in the making or signing of the document are observed.

You have to be legally capable of making a living will

In some provinces you can make a living will if you are as young as 16, while in others you must have reached the age of majority (18 or 19, depending on the province).

To make a valid living will you must also be mentally capable. In some provinces this means you must be able to "understand the nature and effect of the living will," and in others you must be able to "make health care decisions by being able to understand and appreciate the consequences of treatment choices." That's the law . . . but if you're nutty as a fruitcake or comatose, a lawyer won't make a big inquiry into your understanding and appreciation.

Not everyone is eligible to be a substitute decision maker

Not many qualifications are required for a substitute decision maker. In some provinces a person as young as 16 can be named a substitute decision maker, but in others the person must have reached the age of majority (18 or 19, depending on the province).

The substitute decision maker, just like a patient who gives consent, must be mentally capable of understanding and appreciating the consequences of medical treatment choices and decisions. The substitute decision maker has to be mentally capable when called upon to act. That's one reason why it may be a good idea to name more than one substitute decision maker, or to name an alternate.

In Ontario, a person who is being paid to provide health care or residential, social, training, or support services for a person cannot be appointed as that person's substitute decision maker.

Whom should you choose as your substitute decision maker? First, go for someone you feel confident will carry out your wishes. Second, choose someone who isn't going to feel devastated and guilty if he or she has to make a non-life-affirming decision about you. Discuss your wishes in advance not only with your chosen substitute decision maker but also with your whole family so that your decision maker will be supported rather than attacked by your (other) relatives.

Formalities involved in making a living will

You have to sign and date your living will. (If you're physically unable to sign, someone else may sign on your behalf.) Some provinces don't require that a living will be witnessed unless it was signed by someone on your behalf, while others require one witness or even two witnesses (depending on the province) to your signature. Again, ask your lawyer or check with your provincial law society or provincial government for more information.

In cases when a witness is (or witnesses are) required, the substitute decision maker cannot be a witness. Neither can the spouse of the person making the living will or the spouse of the substitute decision maker. The purpose of these rules is to prevent a person from being forced to make a living will or being forced to choose a particular substitute decision maker. The theory is that this sort of thing is less likely to happen if the living will is witnessed by people who have a little distance from the person making the living will and from the proposed substitute decision maker.

After you've made a living will

A living will isn't helpful if nobody knows what it says or can find it when it's needed. Your substitute decision maker could have a lot of trouble persuading your doctor or the hospital that he or she has the right to make decisions without the living will to show. After you've made a living will, give the original to the substitute decision maker — or at the very least tell the substitute decision maker where to find the original.

Put the original of your living will in a safe place, but do not put it in your safety-deposit box! Chances are your substitute decision maker wouldn't be able to get into your box after you became either physically or mentally incapable.

Give a copy of your living will to your doctor(s) for the record. You may also want to give copies to other family members and/or your lawyer.

If you're suffering from a particular disease or condition, keep up to date on what medical treatment is available. You may want to revise your living will to give different instructions if significant advances in treatment occur. And don't forget to revise your living will if something happens to your substitute decision maker.

Book VIII

Taking Care of Business

"Since we lost the dolphins, business hasn't been quite the same."

Contents at a Glance

Chapter 1: Show Me the Money: Sourcing Financing for Your Business 651

Chapter 2: So Long and Thanks for All the Cash 671

Chapter 3: Paying Your Dues: All about Taxes 689

Chapter 4: Close Encounters with Accounting 707

Chapter 5: When Your Business Springs a Leak 723

Chapter 1

Show Me the Money: Sourcing Financing for Your Business

In This Chapter

- Calculating how much money you need to set up your business
- Estimating how much first-year cash you need
- Forecasting your cash flow
- Sourcing financing for your business

If you're starting a business, you need money. Maybe just a little bit, and you already have it; maybe a lot, and you're going to have to scout around for it. In any case, you need to know exactly how much money to hunt for, where to hunt for it, what you're going to have to do to bag it, and what it will cost you.

Your Business Needs Capital

You'll have to spend money to get your business to the point where it can begin operating. These are start-up expenses or capital expenses, things you need to get your business rolling — and very few of them are free. You'll need money to

- Acquire or protect the right to use an idea in your business.
- Identify the nature of your business — researching and developing your product, doing market research, and organizing initial promotional activities.
- Set up your business as a legal entity:
    - And while we're hanging out at the lawyer's, you'll need money for any additional work your lawyer does for you, such as preparing standard documents for your business to use.

- Not to favour lawyers over accountants, you'll also need money for initial advice and assistance from an accountant about the form of your business and how best to structure it to keep accounting difficulties and taxes to a minimum (see Chapters 3 and 4 for more about taxes and accounting).

- Buy equipment and other capital assets (items that last more than one year) for your business. Use Table 1-1 to calculate your start-up capital asset costs.
- Locate your business in its own premises.
- Buy an existing business.

Table 1-1 Start-up Plan — Expenses for Capital Assets and Other Items

List individual items such as	*Cost of individual items*
Furniture and furnishings	**Total cost $**
Desk	$
Chairs	$
Light fixtures and so on	$
Computer hardware and software	**Total cost $**
	$
	$
Web site design	**$**
Business stationery (graphic design, materials, and printing)	**Total cost $**
Special equipment for your business	**Total cost $**
Vehicles	$
Machinery	$
Cost of initial inventory (for a retail business)	**$**

Table 1-2 helps you add up the cost of everything related to start-up.

Table 1-2 Start-up Expenses for a Custom-Built Business	
Your Initial Capital (the money you've already got in your pocket for your business enterprise)	$
Licensing a product to manufacture or use or sell, or patenting your own invention	$
Researching and developing your product or service	$
Initial promotional activities	$
Legal and accounting fees for business set-up	$
Purchase of equipment (just put down the total figure you arrive at when you fill out Table 1-1)	$
Purchase price and legal fees if you buy property for your business premises	$
Leasehold improvements and legal fees to review the lease, if you rent business premises; or renovation costs if you set up a home office	$
Total New Capital (add up Initial Capital plus the costs you've listed)	$
Total Capital Required (subtract Initial Capital from Total New Capital): This is how much you need but don't have at the moment.	$

If you're buying a business instead of building your own, your table of start-up expenses will look like Table 1-3.

Table 1-3 Start-up Expenses If You Buy an Existing Business	
Your Initial Capital (the money you've already got in your pocket to buy a business)	$
Purchase price of business	$
Professional fees (lawyer, accountant, broker, valuator, and so on) associated with the purchase	$
Total New Capital (add up Initial Capital plus the price of the business plus professional fees)	$
Total Capital Required (subtract Initial Capital from Total New Capital): This is how much you need but don't have at the moment.	$

Your Business Needs Operating Funds

After you've figured out the capital requirements of your business, you're still not ready to carry on business . . . at least not for very long. You also have to work out how much money you'll need to run and maintain the business on a day-to-day basis (actually a month-to-month basis), called operating expenses. After your business is generating a steady income, your revenues will cover all or most of your operating expenses. But until then, you'll need to borrow money to pay for such things as

- Salaries
- Lease or mortgage payments
- Utilities such as telephone, hydro, water, and Internet access
- Insurance premiums
- Property taxes, if you own your business premises rather than rent them
- Ongoing professional fees (legal, accounting, advertising, publicity)
- Cost of running any vehicles

Projecting your expenses and revenues

For some of your operating expenses, you'll be able to write down a fairly accurate estimate from a supplier (such as a landlord or accountant or insurance agent). For others (such as utilities, and maybe salaries) you'll just have to guess.

After estimating your expenses, estimate how much revenue you'll bring in to cover your expenses. This step gives you a better grasp of how much money you really need to borrow for monthly operations.

Projecting your expenses is easier than projecting your revenues. But you can make a guess at your revenues, by making some assumptions. The usual assumptions are

- The number of customers or clients you'll get
- The average amount of each sale or transaction

Multiply these two figures together to estimate sales. (Make a note to yourself about how you chose the figures you're using. You'll need to add that information as a footnote to your forecast of projected revenue and expenses.)

Preparing a forecast of revenue and expenses

The figures we discuss in the previous section get plugged into a forecast or projection of revenue and expenses. Take a look at Table 1-4.

Table 1-4 Forecast of Revenue and Expenses (for the first year of operation)

Revenue	
Sales or revenues	$
Other	$
TOTAL REVENUE	**$**
Expenses	
Salaries	
Owner	$
Employee(s) (if any)	$
Lease payments	$
Advertising	$
Insurance	$
Utilities (electricity, heat)	$
Telephone, fax, and Internet	$
Professional services	
Legal	$
Accounting	$
Vehicle operation and maintenance	$
Other	$
TOTAL EXPENSES	**$**
NET PROFIT (or **LOSS**) (deduct Total Expenses from Total Revenue)	$

After filling out this table you have a reasonable idea of what your operating expenses will be for your first year of business, and whether you can expect that by the end of the year your revenues will cover your expenses or that you'll be in the hole (and how deep the hole is).

Projected cash flow

Knowing how much you need to operate your business isn't enough — you also have to know when you need the money. Revenue and expenses rarely match each other exactly, so you can't necessarily expect to be able to pay your expenses out of the revenue you're making. Your revenue may come in a lump sum once a year or a few times a year, whereas your expenses are likely to be fairly steady on a month-by-month basis. By preparing a cash flow statement, you'll know when you may need bridge financing to keep the business afloat. This is especially true during the first year or so of your business's existence, before revenue is steady or before you've been able to put away some profits to operate the business between infusions of income.

Many of your expenses won't change from month to month (lease or mortgage payments, for example), and others may be predictable even though they change during the course of the year (a snow removal contract during the winter months, or salaries for extra staff during a busy season). But if you had trouble estimating your total annual revenue, you'll have even more trouble estimating how it will come in month by month. Give it a shot, though, taking into consideration that your monthly revenue will probably increase over the course of the first year as your business gets established. Your business may have seasonal highs and lows, too. An accountant, for example, can probably expect a high just after income tax returns are filed and the bills go out for tax preparation; a business that sells cards and gifts can probably expect highs just before Christmas, Valentine's Day, and Mother's Day.

We provide an example of a projected cash flow statement to use as a guide in the sample business plan in the appendix. Table 1-5 doesn't have room for all 12 months plus an annual total, so it shows some representative months. (We highly recommend that when you prepare your cash flow statement, you fill in all 12 months.)

Table 1-5 Projected Cash Flow Statement

	Jan	*Feb*	*March...*	*Nov*	*Dec*	*Year*
REVENUE:						
Cash sales						
Receivables						
TOTAL REVENUE						

	Jan	*Feb*	*March...*	*Nov*	*Dec*	*Year*
EXPENSES:						
Salaries						
Lease						
Advertising						
Insurance						
Utilities						
Telephone						
Professional						
TOTAL EXPENSES						
CASH FLOW:						
(Subtract monthly expenses from monthly revenue. If it comes out a negative number, put brackets around the number.)						
CUMULATIVE CASH FLOW						
(Move from left to right adding the previous month's cash flow to the following month. For January you will have the same number as for the January cash flow, but for February you will add the cash flow numbers for January and February together; for March you will add January, February, and March together, and so on. Again, put brackets around negative numbers.)						

Filling out Table 1-5 gives you some idea of how many months of the first year you'll need a loan to pay your operating expenses (from the Cash Flow line), and at what point your revenues will start reducing your need for a loan (from the Cumulative Cash Flow line).

Locating Sources of Financing for a Start-up Operation

After you read through the previous sections, you know, more or less, how much money you need to start up and run your business for the first year. You just don't know where you're going to find that money. Generations of businesspeople have wondered the same thing, so by now a standard list of sources of money exists. The sources include

- Personal assets
- Love money
- Borrowed money
  - Credit card
  - Mortgage or line of credit on home or vacation property
  - Commercial loans (capital and operating)
  - Micro-credit loans
  - Equipment leasing
- Credit
  - Suppliers
  - Customers
- Sale of accounts receivable
- Delay of accounts payable
- Grants and loans from government
- Investment from external sources
  - Angel investor
  - Venture capital company

That's a respectable-looking list — somewhere among all these possibilities you should be able to find a buck or two.

The federal government Web site Strategis (`www.strategis.gc.ca`) maintains a Sources of Financing page that provides information about different types of financing and financial providers, a directory of Canadian financial providers, and a search tool that allows you to search for financing available in your province or territory. The easiest way to reach the Web page is to go to the Canada Business site (`www.canadabusiness.gc.ca`) and click the link to Financing, then Sources of Financing.

Mix-and-match financing

Most businesses need a combination of financing. For example, besides using personal assets and love money to get started,

- To get equipment, a business might need
  - A capital loan
  - A conditional sales agreement
  - A lease

- To get operating funds, a business might need
  - A line of credit
  - Payment in advance from customers and clients
  - Credit from suppliers
- To make leasehold improvements, a business might need a capital loan

So you'll likely be dealing with several sources of financing.

Personal assets

Most entrepreneurs start off using at least some of their own money. Look around and see what money you have handy — or what property you could turn into cash — to finance your business start-up. Keep in mind you still need money to live on while you're getting your business off the ground. You're not going to be a very effective CEO if you're starving or sleeping on the street. Consider whether you have

- Money in bank accounts.
- Stocks, bonds, mutual funds, or other investments — but if they've increased in value since you acquired them, you'll have to declare a capital gain on your next income tax return and could end up taking a tax hit.
- RRSPs — but remember you'll have to add any amount you withdraw to your income for the year and will also have to pay withholding tax at the time you withdraw funds.
- Personal property or real property you can sell, such as vehicles, jewellery, collectibles, art, a vacation home . . . or even your real home. If property other than your real home (your principal residence) has increased in value since you acquired it, you'll have to declare a capital gain on your income tax return and may have to pay tax.

Rather than sell your assets, you could pledge them as collateral for a loan to start your business.

Money from friends and family

Family and friends may be willing to lend money to you, or they may be willing to give it to you flat out. Think very carefully, however, before asking relatives and friends for money. If your business tanks and you can't repay them, they'll probably stop speaking to you. Then you'll have not only no business, but also no one to give you any sympathy either. Blood and money seldom mix.

If you do go ahead, make a formal arrangement with the lenders, for two reasons — first, so they can get something back if you're successful or if you go bust (a document will provide the evidence they need to make a claim against your business as a creditor); and second, so they can't demand their money back just when you desperately need it. If the money or property is a gift, the giver should sign a document stating the money or property is a gift and is yours absolutely to do with what you like. If the money is a loan, make sure you have a contract (a *promissory note*) with the lender setting out

- The amount of the loan.
- The rate of interest payable on the loan (if any).
- The amount of each payment and the dates they will be made (for example, a schedule of payments).
- The nature of the security, if any, the lender wants for the loan (something the lender can take in exchange if the loan isn't repaid). Security could include a mortgage against your home, or the taking of shares in your corporation, or a promise from someone else associated with you or the business that he or she will repay the loan if you don't (this is a *guarantee*).

Money borrowed from commercial lenders

Commercial lenders are banks, trust companies, credit unions, caisses populaires, finance companies, and insurance companies. They've got lots of money . . . if you can just get your hands on it.

Many commercial lenders can also help you get access to funds from the Business Development Bank of Canada (visit their Web site at `www.bdc.ca` for more information about their lending activities) and from the federal government's Canada Small Business Financing (CSBF) program. Most small businesses starting up or operating in Canada are eligible for CSBF loans, as long as their estimated annual gross revenues do not exceed $5 million during the fiscal year in which they apply for a loan. For more information about CSBF loans, go to the Canada Small Business Financing Web site (part of Strategis) at `www.ic.gc.ca/epic/site/csbfp-pfpec.nsf/en/home`, or go to the Royal Bank Web site (`www.royalbank.com`) and follow the links to the business banking and financing options.

Credit cards

If you need to borrow from a bank or credit union, your first thought may be to use your credit cards. It's easy — no application forms to fill out, no waiting, no business plan to prepare, no intimidating interview with a loans officer. You may even have a high enough limit on your card(s) to get as much money as you need.

Don't do it! The interest rate on credit cards is astronomical compared to the interest rate you'll pay if you borrow in a more business-like fashion — probably at least double and maybe triple. We have better suggestions here.

Mortgage on your home or vacation property

If you own real property and it isn't already mortgaged to the hilt, you can borrow against that property by taking out a mortgage. If you're thinking of mortgaging property, consider these factors:

- **What's the property worth?** Will mortgaging it get you as much money as you need? You probably won't be able to borrow its full unmortgaged value.
- **Is the property already mortgaged?** If it is, there may not be enough equity (unmortgaged value) in the property for you to get as big a loan as you need.
- **Do you need someone else's legal consent to mortgage the property?** You do if you have a co-owner. Even if you're the only owner, if you're married, in most provinces your spouse will have to give consent to the transaction before you'll get any money (sometimes even if it's not your family home you're borrowing against).
- **Can you afford to lose the property if your business fails?** If you default on your loan (don't pay it back on time), the lender has the right to take the property — and either keep it or sell it to cover your unpaid loan. (If it's sold, you'll get the excess over the outstanding amount of the loan plus legal and real estate listing fees; see Chapter 5.)

Business loans

If you're borrowing because you need money to purchase capital assets for your business, you'll apply for a *capital loan*. If you're borrowing because you need money to cover the ongoing costs of running your business, you'll apply for an *operating loan*. You can go looking for either kind of loan from a commercial lender. But choose a branch that regularly handles small business clients, if you can find one — if the branch staff are only used to making deposits and withdrawals, they won't know what to do with you . . . and the easiest thing will be to show you the door.

Banks, most credit unions, and many trust, loan, and insurance companies can make a loan under the Canada Small Business Financing (CSBF) program for capital expenses including the purchase or improvement of real property, leasehold improvements, and the purchase or improvement of equipment. The federal government partially guarantees CSBF loans, so lenders are more willing to lend, and owners don't have to provide personal assets as security (see the section "Non-repayment of the loan" a bit later).

Chances are good that at some point you'll want a business loan, so now we tell you about loans in detail.

Principal and interest

The amount of money the lender gives is called the principal, or principal amount of the loan. The amount the borrower pays for the use of the money is called interest. (You're not going to find an interest-free loan if you deal with anyone other than your mother.) Interest is calculated as a percentage of the principal. If you're charged *simple interest* on the loan, you pay interest only on the principal you've borrowed. So if you borrowed $100,000 at 10 percent, you'd owe $10,000 in interest per year.

But commercial lenders charge *compound interest* on a loan if the terms of repayment stretch past the time the interest is actually due. Compound interest is interest on the principal and on the interest owing. When you're charged compound interest, you end up with a higher interest rate (the effective interest rate) than the rate you're quoted (the nominal interest rate). And the more often the interest is compounded, or calculated, the higher the real interest rate.

Interest can be compounded on any basis the lender chooses — daily, weekly, monthly, semi-annually, or annually. If you borrowed $100,000 at 10 percent compounded monthly, your real interest rate would actually be 10.47 percent. And in commercial loans, unlike consumer loans, the lender doesn't have to tell the borrower the total amount of interest payable over the life of the loan (the cost of borrowing).

Repayment of the loan

You'll likely take out either a term loan or a line of credit. Capital loans are usually term loans. Operating loans usually come in the form of a line of credit. If you have a term loan, the lender sets a schedule for regular repayment of principal and interest.

If you have a line of credit, also known as overdraft protection, the lender (which is normally your bank) tops up your business account if you don't have enough in the account to cover a cheque. Then when you make a deposit to your business account, the money is automatically applied to pay down the loan. You may also be required to make regular payments or make a deposit to the account within a fixed period of time to cover the overdraft.

A line of credit is usually a *demand loan,* which means the lender can demand payment in full at any time, not just after you've missed a payment. However, if you make your payments on time, demand will not be made — unless you do something to lead the lender to believe your business is in trouble. The

lender also usually requires you to sign blank promissory notes, which it fills in as the line of credit goes up. The promissory note provides evidence of what you owe, and the lender can also sue you on the note if you don't pay the loan.

Non-repayment of the loan

Lenders don't take it for granted that borrowers will pay up on schedule — or ever. They know they could sue the borrower for failing to pay, but they also know that suing someone is expensive and time-consuming, and even if they win the lawsuit it's often difficult to collect the money. So to make life easier for themselves, lenders usually require borrowers to give security or collateral. When a borrower gives security, he legally gives the lender the right to take specified property from the borrower if the borrower doesn't make his payments. The lender usually sells the property to pay off the loan. Typically, lenders take security on such property as

- **Real estate —** security will take the form of a collateral mortgage or charge or, in Quebec, a *hypothec*
- **Equipment and other non-land assets —** security may take the form of a chattel mortgage, known in some provinces as a specific security agreement
- **Accounts receivable, also known as book debts, which is money that customers or clients owe the borrower —** security can take the form of an assignment of accounts receivable, which gives the lender the right to collect debts owing to you if you default on your loan
- **Inventory —** the lender may be able to take security under s. 427 of the federal *Bank Act* if you are borrowing from a chartered bank

If you have a capital loan, the lender will probably want security over the capital property (real estate or equipment) you're buying. If you have a line of credit or overdraft protection, the lender may want security over your business's accounts receivable and inventory.

Other forms of security a lender might ask for include

- **A general security agreement:** This gives a lender security over almost all of the borrower's existing and future assets (usually excluding real property, but including equipment, vehicles, machinery, inventory, and accounts receivable).
- **A debenture:** This is much like a general security agreement, except that only a corporation can give a debenture as security for a loan, and a debenture usually includes real property as well as other assets.

- **A pledge of shares (or of bonds or debentures) that are the personal property of the borrower or a guarantor:** For example, if the borrower is a corporation, the lender may want a pledge of shares of the corporation from the shareholders who have guaranteed the loan. Then, if the borrower does not repay the loan, the lender can take control of the corporation.

And lenders don't always stop at taking security. Sometimes they want (instead of or in addition to security) a guarantee. A guarantee is a promise by someone other than the borrower that if the borrower doesn't pay up, the guarantor (the person or business giving the guarantee) will repay the loan. For example, if the borrower is a corporation — especially a corporation that doesn't have much in the way of assets — the lender might ask for a guarantee from the individuals associated with the corporation, such as the shareholders or the directors. A bank can also ask for security, such as a *collateral mortgage* on the guarantor's home, from the guarantor.

If the borrower does not meet the lender's criteria to receive a loan, the lender may be willing to go ahead with the loan if someone who *does* meet the criteria agrees to co-sign the loan. Unlike a guarantor, a co-signer can be required to repay the loan even if the borrower is capable of repaying the loan himself.

Micro-credit funds

Micro-credit is a small loan (under $25,000, often only a few thousand dollars), available to individuals with a low income to help them start up a very small business. (They're often targeted toward young people, or women, or new immigrants, or people with disabilities; they may be targeted toward a restricted geographical area.) They can be used for capital investment or operating funds. They often offer, besides money, business courses and networking opportunities. Micro-credit may be made available by an independent operation, as part of an integrated community economic development program, or by a micro-finance program of a commercial lender.

Credit from suppliers and clients

Maybe you didn't realize you could put your suppliers and customers to work for you as lenders.

Suppliers

If you're buying equipment or machinery, you may be able to finance the purchase through a loan from the vendor, a conditional sales agreement, or a lease. The vendor will probably want a down payment as security (for example,

a chattel mortgage if the vendor is loaning you the money), and will want to be repaid on a regular schedule, as would a commercial lender.

If you're buying inventory or supplies, you may be able to get financing through a credit arrangement. Suppliers may offer 30, 60, or 90 days to pay, with a discount if payment is made within a shorter time. (Two problems here: first, because you're a start-up without a credit history, suppliers might not want to extend credit and might instead want cash on delivery from you; and second, the effective interest rate you pay on the money you're "borrowing" by not taking the discount is high — in the range of 20 to 30 percent or more.) Suppliers might also sometimes offer a loan, or a sale on consignment (you don't pay the supplier until a customer purchases a consigned item). If you buy inventory on credit, the supplier may want to take security in the form of a *purchase money security interest*.

Customers

You may well be able to get your clients or customers to finance the work you do for them by getting them to pay a deposit or *retainer* (what professionals call a deposit) and/or instalment payments as you do the work (instead of waiting to be paid when everything's finished).

Sale of accounts receivable

You can sell your recent accounts receivable at a discount for instant cash. This is called factoring and it's more expensive than borrowing — it can be a *lot* more expensive — but you don't have to show that your business has revenue and you don't have to put up security. The factor pays you a percentage of the value of your receivables immediately, collects the receivables, deducts fees, and sends you the balance. (Depending on your arrangement with the factor, your customers needn't know they're dealing with a factor instead of with your business.)

The initial percentage you get from the factor will depend on things like the value of the receivables, number of customers, and creditworthiness of the customers — it can run anywhere from about 90 percent down to 30 percent. In "recourse" factoring, the factor can look to you to cover any bad debts, while in "non-recourse" factoring (which is, naturally, more expensive), bad debts are the factor's problem. Factoring is available from factoring companies, finance companies, and some banks. It's traditionally used in the apparel, textile, carpet, and furniture industries, but it's not restricted to those industries.

Government loans and grants

You too may be able to snarf up some money from the public trough to start and run your business! You can find some government assistance programs — go to the Industry Canada Financing Web page at `www.ic.gc.ca/epic/site/ic1.nsf/en/h_00073e.html` to find out more. You can also search for government business financing available in your province. For example, you might be able to get some repayable or even non-repayable money from

- Human Resources and Social Development Canada, if you need to hire or train an employee
- The Industrial Research Assistance Program (IRAP) of the National Research Council, if you need to research and develop a new technological product or service
- Canada Council for the Arts, if your business involves artistic creation (like writing, painting, music, or performance)
- Industry Canada, for various initiatives

Arm's-length investment

For some businesses, a start-up loan isn't much use. If you take out a loan, you have to pay it back — usually beginning right away — but your business, even though it has fantastic prospects over the next few years, won't be able to generate cash revenues for some time *and* it needs a cash infusion (perhaps a big one) to get started at all.

So maybe what you need is seed financing or seed capital from an investor such as an angel or a venture capital firm, rather than a loan from a lender.

Seed capital provides money for such things as

- Proving an idea or invention actually works in practice as well as it does in theory (proof of concept)
- Protecting intellectual property (usually through a patent)
- Completing a prototype (working model) of a product or invention
- Doing market research
- Creating strategic partnerships with other businesses or with potential customers

- Hiring experienced managers for the business
- Creating a business plan
- Hunting down even more capital that's required to start operating the business

The great majority of start-up businesses don't need seed capital for these kinds of things. And even start-ups that do aren't that likely to get outside investment in the business. Most requests for investment get rejected either because the business has limited financial prospects or because the managers of the business don't have the necessary skills to run the business successfully.

Angel investors

If you go around talking about angel investors, chances are most people will think you've been out in the sun too long. You'll get the same kind of reaction as if you mentioned that aliens are broadcasting messages to you through the fillings in your teeth.

Angel investors actually do exist, however. They are individuals, often successful businesspeople, who want to invest their own money in promising new businesses, usually in the same field the angel comes from (many or most come from a high-technology background), and usually in businesses in their own geographic area.

What angels offer

Angels usually invest an amount in the range of $10,000 to $150,000, although some may go as high as $500,000 or more if they've got the money and they like the business's prospects. Besides providing money, angel investors also take an interest in the running of the business. Because they're experienced, they may be able to help you find customers and sell your product, put you in touch with suppliers and professional advisers, and prepare you and your business to hunt for the next round of financing.

What angels are looking for

Angels are looking for a good return on their investment in your business — typically 30 percent compound annual returns. Not many business owners even plan for their business to grow that aggressively; many fewer are capable of making it happen. Angels are also looking for equity in (a share in the value of) your business and the right to be involved in major decisions and to get frequent status reports.

Where to find an angel

Heaven? Sure, but maybe closer than that. Network in your own business community and ask around about angel investors. Ask your lawyer or accountant. Some business incubators help to connect client companies with angel investors. Or you can try the National Angel Organization (`www.angelinvestor.ca`). Finding one at all is a matter of luck, and if you do find an angel, he or she won't necessarily be interested in investing in your kind of business. Learn as much as you can about an angel before approaching him or her, and customize your pitch to match the angel's interests.

Venture capital

Venture capital is money that's available for risky investments with a good chance of getting a high return on the investment. More than $65 billion in venture capital is floating around in the Canadian economy at the moment, and in the past few years venture capitalists have poured well over $1 billion per year into businesses. However, that doesn't mean you'll be able to get any of it. Venture capitalists are ridiculously fussy about whom they give their money to.

What kind of business opportunities is a Venture Capitalist looking for?

Venture capitalists (VCs) are typically looking for three things:

- **A large market opportunity** — one that will provide very high returns within a fairly short time, about five to seven years (the majority of investments are made in technology)
- **Good managers** — or at least one good and committed manager who will be able to recruit a strong management team
- **A strategic plan about building the business** — one that includes a lucrative exit strategy (see "What a VC wants in return") for the venture capitalists

What a VC can offer

Like angel investors, venture capitalists offer money, management expertise, and connections — to other money, to professional advisers like lawyers and accountants, and to suppliers and potential customers.

What a VC wants in return

To put this section in perspective, we'll tell you that venture capitalists are also known, affectionately of course, as vulture capitalists. What they usually want is

- At least a 25 percent return on investment; they're really thrilled at the prospect of getting a 300 to 500 percent return (a "home run")
- Significant ownership of the business — usually 20 percent or more of the business's equity, plus their own pet director(s) on your board of directors
- A lucrative exit strategy within five to seven years. Exit strategies include the following:
  - An initial public offering (IPO)
  - Sale of the business to another corporation
  - A company buy-back (the business or business owners buy back the VC's share of the corporation)
  - A write-off of the investment (as lost money) . . . although clearly this is not considered lucrative

Where to find a VC

Venture capital firms, unlike angels, are very easy to find. You can get a list of them by going to the Canadian Venture Capital Association Web site (`www.cvca.ca`), and from there you can link to the home Web site of each association member. You'll be able to get contact information, as well as some information about the interests and expectations of each member, from their Web site. Finding them, of course, does not necessarily mean getting money from them.

Chapter 2

So Long and Thanks for All the Cash

In This Chapter

- Getting money from a commercial lender
- Finding out what's required — an application or a full business plan
- Getting help to write a business plan
- Investigating what goes into a business plan

Sometimes preparing an application to get money involves filling out a form created by the lender, and sometimes it involves preparing a business plan. Most of this chapter focuses on a formal business plan, because it's a lot more difficult to prepare a business plan than to fill out an application form.

Preparing a business plan is usually looked upon as a thoroughly intimidating activity, so we wanted to give this chapter a comforting title. We could have called the chapter "DON'T PANIC!", but that might have tipped you off, and you would have bypassed the chapter completely.

Don't Panic!

All business books contain a chapter on writing a business plan. It's required. You can't get a licence to publish a business book unless you include a chapter on business plans.

However, to get you off on the right foot, we're going to start by telling you why you shouldn't panic at the thought of having to read the chapter — or of having to prepare a business plan.

First reason not to panic

You don't always have to prepare a formal business plan to get money. When you're looking for money, the first thing to do (after identifying a source of money) is contact the source and find out what documentation they want in order to consider your request. Especially for smaller amounts of money (say, under $35,000 to $50,000), the source may want only a limited amount of information about your business. (See the section "Filling Out an Application Form.") Or the source may not need a full-strength business plan and instead be willing to settle for a mini business plan (see the section "A mini business plan").

Second reason not to panic

Most business books put the business plan chapter almost at the very beginning, where it's especially unnerving. Who knows how many people have decided not to go into business because they couldn't face writing a business plan as the first step in starting a business? And nobody's able to put together a description of their business and an analysis of the marketplace, and financial statements, before they've even thought about their product or service, their business organization, what equipment they'll need, where they'll be located, and what sources of funding are available to them.

We avoided putting our business plan smack at the beginning for a reason. By the time you get here, you've done a lot of the work needed to create a business plan — and you didn't even know you were doing it. Besides that, Chapter 1 motivates you to get some money.

Third reason not to panic

Here's yet another reason not to panic: Even if you have to prepare a business plan, you don't have to prepare the business plan on your own. For one thing, you can purchase business plan software, such as Business Plan Pro, or download free business plan software from CNET Download.com (`www.download.com`). For another, if you don't feel like doing this all by yourself — just you and the software — you can go to your accountant. Your accountant should be able to put together at least the financials for your business plan after talking to you for a couple of hours about your business and what you're planning to do with it.

You can also find consultants who can write a business plan for you. (Expect to drop several thousand dollars on a consultant.) It's probably best to use a consultant who works in the field of your business rather than one who simply specializes in writing business plans.

You can find consultants (you can find consultants galore, most likely) by asking around among your business acquaintances, or approaching your provincial Canada Business Service Centre (CBSC) or a municipal or regional economic development office for their help or suggestions about whom to contact. You can also get in touch with a university business school — MBA students run assistance programs, and for a modest fee will work with you on a business plan.

Taking Your First Step

Before you write down one word or add up two numbers, contact the source of financing you're interested in. Tell them how much you want to borrow and in what form, and then ask about the application process. If they say you just have to fill out a form, get the form. If they say you have to prepare a business plan, ask if they have any guidelines or forms to show what they want to see in the business plan. If they don't, you have to do it yourself — but in this chapter, we offer a lot of help about the form and content of a business plan.

Filling Out an Application Form

You may only need to fill out quite a short, simple application form to apply for the money you need. Typically, an application form will ask you to give information about how much money you want and what you're planning to use it for, and also about

- The business's primary financial institution (it might or might not be the institution you're requesting the loan from)
- The name, trade name, and address of your business
- The form of your business (sole proprietorship, partnership, or corporation)
- The nature of your business
- The length of time the business has been established, and the number of employees it has
- The financial problems and setbacks your business has experienced (if any), such as claims from creditors and lawsuits, and whether the business has ever been in receivership or declared bankruptcy

The application form will also ask for a summary of financial information about your business, including

- Total gross annual sales or revenues for the preceding fiscal year (if you've been in business for more than a year) or as projected for the year ahead (if you're a start-up)
- Net after-tax profit or loss (for the preceding fiscal year if you've been in business for more than a year, or as projected for the year ahead if you're a start-up)

Be prepared to provide the financial statements themselves. For information about preparing financial statements, see Chapter 4.

Finally, the application form will ask for information about the owner(s) of the business, including

- Names and addresses
- Income in the preceding year (as reported on the owner's tax return)
- A list of each owner's assets and debts (in the "Preparing a Business Plan" section, we have a personal balance sheet that will show you the kind of information the lender has in mind)

For a start-up business, the decision whether to lend will be based as much on the owner's personal financial status as on the business's, because start-up businesses normally don't have much in the way of assets.

If the owner has no assets, the lender will be very reluctant to lend the business any money. Probably the best indicator of whether you'll get the loan is if you own a home (one that's not 100 percent mortgaged already). The lender will feel much more comfortable giving you money if it can take back a mortgage as security. (See Chapter 1 for more about security for a loan.)

Preparing a Business Plan

Sometimes no other way exists . . . if you want money you'll have to prepare a business plan to submit to the lender.

A business plan sets out how much money you want and what you're going to do with it, describes your business, places it within the context of the industry it belongs to, examines the marketplace and competition and sets out a strategy for competing in the marketplace, and provides detailed financial information about your business.

A lender or investor looks at a business plan to see whether it's safe to put money into your business. If your business is well thought out, it's more likely to be successful, generate a profit, and be able to repay the lender or investor.

When you show someone a business plan, you're revealing a lot of important information (important to you, at least) about your business. If you want to impress on the potential lender or investor that this information shouldn't be broadcast around the solar system, you may want to ask the lender or investor to sign a confidential disclosure agreement before looking at the business plan.

Checking Out What Goes into a Business Plan

Books and even chapters about business plans are often incredibly detailed and seem to be written for existing businesses looking for huge amounts of money to expand. They're intimidating, and by the time you get to the end of the book or chapter, you feel like no point exists in writing a business plan because you don't have an MBA and you don't understand the marketing and accounting jargon.

Don't twist yourself into knots about writing a business plan. Although almost every book or article you read about creating a business plan will tell you a somewhat different way to set the plan up, all business plans contain, in the long run, the same — quite understandable — information.

A full-scale business plan

If a lender is looking for the whole shebang, business-plan-wise, here's the information required:

- The amount of money you want from the person who's reading the business plan and what you're going to do with it.
- A description of what your business does, and a description of the industry your business is part of.
- An explanation about why your business can compete successfully, and your strategy for competing (that is, for marketing your product or service).
- A description of how your business runs or will run on a day-to-day basis, including information about the business's managers.
- The financial information about your business, including projections about revenue and expenses (as a start-up you won't have much in the way of a financial history), and also about your personal financial status — so the lender or investor can decide whether it's safe to invest.

> A lender or investor will expect to be paid back out of the revenue, or better still out of the profits of the business or (if the business doesn't generate enough profits) out of the sale of what the business owns . . . and/or what you own.

A mini business plan

If the lender doesn't want to know every last detail about your business (and who can say whether the lenders who do want to know every detail actually read the business plan from cover to cover?), you need to prepare only a short version. A mini business plan would cover any given topic more briefly, and it might include only

- The amount of money you want from the lender and what you'll do with it
- The name and address of the business, form of business, and how long it's been established
- The nature of your business, and what its goals are
- A basic analysis of your market and competition
- The financial statements

Stating How Much You Want (Your Objective)

Say right upfront how much money you want and what you're going to do with it. Also say right upfront how this money will increase revenue first and then the profits or value of the business so the loan can be repaid or the investment can provide a return.

No, it's not rude or pushy to start by saying what you want. You'll save your potential lender or investor time and annoyance. No one with money wants to plod through pages of information without knowing beforehand why they're plodding. They'll want to assess what you want against what you have — and against what they have — to offer from the very beginning of your plan.

Describing Your Business

Next, the plan describes your business and how your business fits into the larger industry it's part of.

Your product or service

Start with what your business does — what product it manufactures or sells or what service it provides.

For example, if you're firing up a bakery operation, you'll describe the baked goods you're going to produce and your potential customers. If you're setting up a bookkeeping practice, you'll describe the services you plan to offer and to whom.

If your business has an intellectual property component — for example, if you're

- Manufacturing a product that's patented or whose design is registered as an industrial design
- Distributing or selling a product under a licence agreement or marketing a product under a trademark

then your plan should describe the status of protection of the product or service. For instance, if your product or method is patented, say so and mention its patent number; if you've applied for a patent, say a patent application is pending; if you're distributing a patented product, talk briefly about the licence agreement you have.

For a business that needs money to start manufacturing a product, be prepared to show a potential lender or investor working drawings and designs of the product.

The goals of your business

While your immediate goal is to get your business set up, you presumably also have other goals on the way to success. An investor would like to know where you're headed. So your plan should outline

- Your short-term goals
- Your long-term plans

In the case of the bakery, for example, your short-term goal might be to produce ten dozen loaves of bread per day within a month of starting the operation and distribute them through five local independent food stores. A longer-term goal might be to produce 100 dozen loaves per day and distribute them through a grocery chain with stores around your city. Your ultimate goal (for the moment) might be to expand your baking operation to the point that it supplies bread for the grocery chain throughout the province; or it might be to franchise your bakery and sell franchises across the country.

If you think your business might attract a lot of interest from the world at large (and not just from your doting family and satisfied customers) and will need a large amount of invested money to expand and function properly, your long-term goal might be to become a publicly traded company. Publicly traded companies are able to raise money by offering their shares to the public through a stock exchange.

If you think your business is likely to be of great interest to one or more large corporations in the industry, and that a large corporation would show its interest via a nice fat offer to buy you out, your long-term goal might be to sell your business to a larger business.

Your business within the industry

Your business won't be operating in isolation. Even if you haven't thought about it that way, it's part of some fairly large-scale industry. Your bakery is part of the baked goods industry, your bookkeeping practice is in a small corner of the accounting industry, your computer program for hunting down certain kinds of information on the Internet is part of the computer software industry. The lender or investor you approach may not know much about the industry at all and will need background information to make a decision.

So write a short profile of the industry. To do this you'll have to conduct some research by contacting industry associations, reading industry publications, searching for newspaper and magazine articles, or going through Statistics Canada data.

Think about including:

- **The size of businesses in the industry:** Some businesses are mainly made up of large multinational corporations, like the pharmaceutical industry; some are mainly made up of national corporations, like the Canadian banking industry (although you're probably not thinking of starting up a bank); others may have a mix of large and small businesses, like the legal and accounting industries; and some mostly consist of small businesses, like the personal services industry.
- **The total volume of sales in the industry and the total value of sales:** You're going to have just a small piece of the pie to start with, but it's good to show that the pie is nice and big.
- **Any legislation, regulations, and standards that apply to the industry's products or services:** For example, the manufacture of food and drugs is heavily regulated by the federal government; travel agencies are regulated by provincial governments; cafés are regulated and inspected by municipal governments.

- **Trends in the industry:** It might be growing, or shrinking, or shifting its focus from certain products or services to others; or it might be facing stricter government regulation, or it might be about to be deregulated.
- **The main challenges and problems the industry faces:** Is it being forced to compete globally instead of nationally? Is it losing customers because it isn't meeting changing customer needs? Has it priced its goods or services out of the larger marketplace? Is it sluggish because it hasn't upgraded old infrastructure?
- **The future of the industry:** Will it stay much as it is but expand — or contract? Will it change significantly in response to consumer demand or new legislation?

By the way, don't make this stuff up. Making it up is easier and more fun, true, but it's a bad move. It will make you look light-minded and untrustworthy if anyone finds out.

And because you're not making it up, go ahead and footnote facts and opinions you state to show their source. If a lender or investor wants more information about the industry, he, she, or it should be able to locate your references.

After you've finished your industry profile, discuss how your business fits into the industry. Are you going to create a product that will revolutionize the industry . . . or even make it obsolete? Are you going to take advantage of a gap and expand your business to become a major player? Are you going to quietly but competently fill a little niche? How will industry trends affect your business's chance of success? How will your business meet the industry's challenges? How will your business fit into the industry's future that you've projected? This section is going to give you quite a mental workout! But preparing it will make you reflect on a lot of points that are important to your business success.

Why your business can compete successfully

After you've described your business world, show you can survive in it by competing successfully. In trying to figure out how well you'll be able to compete, consider both the market for your product or your service, and your competition in the marketplace.

Your market

You need to know a reasonable amount about the market for your product or service so you'll be able to

- Identify your target market for the product or service
- Identify your portion of the total target market (it's probably not going to be the total market, at least not to begin with)
- Identify marketing strategies (covering things such as prices, distribution, and business promotion)

Your target market

You can determine your target market in different ways. One is geography. Your target market may be the people (or businesses) within a geographic area. For example, if you run a retail business, you may see your target market as the people who live within walking distance or a short driving distance of your store. If you're distributing a product, you may have a distribution agreement with the manufacturer that allows you to distribute the product within your province or within a region (for example, the Atlantic provinces, or the Vancouver area, or specified towns in northern Ontario). If you're the sole manufacturer of a product that's in demand (say, a hula-hoop during a hula-hoop craze), your geographic market might be the entire country or the entire continent.

Another way of determining your target market is by the characteristics of your customers or clients — for example, sex, age, interests or needs, and/or income level if your customers or clients are individuals; or kind of business and/or annual sales if your customers are other businesses.

Your share of the target market

Besides figuring out who or what your target market is, try to estimate what share of the target market your competitors hold and what share you can capture. This is guesswork unless you've got very few competitors. As an example, if you open a convenience store in a residential area where no other stores are located, you've got a good chance of getting a very big share of the target market (which is the inhabitants of the residential area). But — to take an example from the opposite end of the spectrum — if you're planning to sell T-shirts over the Internet (a huge total market), you may never be able to estimate your market share or a competitor's with anything approaching accuracy because many businesses are competing in a fickle market.

If you're looking for a large sum of money, it would be worth your while to have a professional marketing study done to examine in detail the size of the market, the existing competitors in the market, and the market share your business might expect to capture.

Marketing strategy

When it comes to identifying a marketing strategy, take lots of details into account. They include

- **Your planned method(s) of selling and/or distributing your product or service:** Are you going to sell direct to the end user, or are you going to go through a third party (such as a manufacturer's agent or a distributor or a retailer, if you're a manufacturer)? If you already have contracts or partnerships with individuals or businesses or governments who are going to buy or distribute your product or service, mention them here.
- **Your location (if it has an impact on marketing):** Your location is important if, for example, you're a retail store or service relying on walk-in customers, or if you provide a product that can be shipped only short distances to customers, or if you need to project an image to customers that can be achieved in only a certain area. It's not particularly important if you provide a service or product without needing face-to-face contact with your customers or clients — for example, if you run a call-centre operation. Then it's fine to be in an industrial plaza in the middle of nowhere . . . as long as you can get workers to go there.
- **Your strategy for promoting the product:** This covers things like
  - **Your business image:** How are you going to present your business? Are you going to package it around a logo or trademark? Are you going to build it around a concept (such as one-stop errand running if you're starting up a rent-a-wife business) or a special product? Are you going to promote it as an essential for your target market (such as a business-district spa for businesswomen)?
  - **Your advertising message:** What's your message, and your method and budget for getting the message out? Methods might include TV and radio spots, a spiffy Web site, newspaper ads, billboards and signs, flyers distributed around neighbourhoods or to local businesses — or even just word of mouth. The method should be appropriate to the target market and to the image you want your business to project.
  - **Your public relations plan, if any:** Do you have a plan for approaching the media (in the hope they'll write about you or interview you on TV news or on a business program or on a lifestyle show), providing lots of chat on a busy business blog or organizing events to attract media and customer attention? Media approaches might include press releases, contacts with acquaintances or friends-of-friends, or cold calls.
  - **Your sales strategy:** How are you going to set your basic price? (Generally speaking, it should be high enough to cover your costs of providing the product or service and earn you a profit, and low enough that your competitors are not underpricing you.) What other pricing procedures are you going to use to attract customers and clients? (Possibilities include gifts, coupons, or two-for-one offers; special sales to groups; or special rates for large purchases of your product or time.)

- **Finding and keeping customers:** What's your plan for coming up with leads to find new customers and clients? (Tried and true methods include advertisements, arranging for other individuals and businesses to refer clients to you, and buying customer lists.) Are you going to make presentations to prospective clients or customers? What will the content of the presentation be, and how will you jazz it up to give it impact? How are you going to satisfy the customers you do get? (Think about a returns policy, guarantees, and on-site service calls.)

Your competitors

You need to know your market, but you also need to know your competitors. If you can't beat them at their own game, that will be the end of you.

In this part of your business plan, you

- **Fearlessly name your competitors.** Remember, though, you're talking about your competitors in your target market and not all the competitors in the total market. If you're starting a dog-walking business, your competitors aren't every personal-service provider in the province, or even every dog-walker in the city, just the dog-walkers in the neighbourhood you plan to service.
- **Describe the similar products or services available from your competitors.** What are the strong points about the competing products or services, and what are the weak points? What problems exist with the competition's product or services?
- **Explain why customers will buy the product or service from you instead of buying something similar from the competition.** Describe the strengths of your product or service.

Strong points of either the competitors' businesses or your business might include

- Higher quality of services or product
- Innovative nature of the product or service (being the first to provide a product or service can give the provider a competitive edge — but keep in mind the first provider isn't necessarily the best provider)
- Lower cost of services or product
- Better distribution system
- Better management

- Better customer service — efficient, fast, friendly
- Better service guarantees that accompany the product or service
- A more convenient location
- Established base of loyal customers or clients
- Loyalty of customers or clients to a particular brand
- Access to a client/customer base that hasn't been tapped yet

Weaknesses are the flip side of these matters — such as higher cost of the product, poorer quality of the service, less convenient location, and so on.

Don't overdo describing your competitors' strengths or your own weaknesses. You don't want to deep-six your business proposal by presenting the competition as unbeatable or you as a lost sheep among the coyotes. But you do want your potential investor to know you've taken an objective look at the market and to know your chances of turning a good profit.

Explaining How Your Business Runs

Investors are amazingly curious about how you will run your business. Some even go so far as to say they care less about the product or service the business provides than they do about who's in charge. Poor management can destroy even a great idea, while good management can nurture a less-than-fantastic idea along the path to success.

Business info and history

You're allowed to start with the easy stuff about your business:

- The address, telephone, and fax numbers for the business, and the e-mail address or URL
- A statement about the form of your business (sole proprietorship, partnership, or corporation — see Chapter 3 for forms of business organization)
- A description or picture of any business logo, design, trademark, or trade name you're using
- A brief history of the business, including the date of business start-up

Business managers

Then you get down to the nitty-gritty: Who's running this show? Here you list key people (it may be a short list) and their titles, if any:

- **The owner(s) of the business:** The sole proprietor of a sole proprietorship, the shareholders of a corporation, the partners in a partnership.
- **The manager(s) of the business and the compensation the manager is to receive:** For example, the managing partner of a partnership, or the CEO (chief executive officer) of a corporation. Each manager's CV (*curriculum vitae*, or resume) should accompany the business plan. And it should show that the manager has relevant business experience. If you're a novice at running a business, your CV should at least show you've got related work experience and/or you've attended some courses or workshops on setting up and managing a business. If you're starting a complex business or one that requires a lot of money (hundreds of thousands or millions of dollars) at the outset, don't fool around playing CEO if you're not a seasoned professional. Investors won't look at your business unless you've got a professional with a track record in place.
- **The key employees of the business:** For example, the person responsible for sales and marketing or the person in charge of research and development.
- **The inventor(s) or creator(s) of the idea on which the business is based (if any):** For example, the inventor of a drug or medical device, or the designer of a product the business is going to manufacture. If at all possible, you want the creative brain behind the business to come along with the business. Have an inventor or creator provide a CV to attach to the business plan.
- **The professional advisers of the business:** The lawyer, accountant, publicist, advertising firm.
- **The investors already on board:** These could be you (via your bank account, investments, sale of property, and so on), your family and friends who loaned you cash or contributed equipment, the bank that gave you a start-up loan, or some other arm's-length investor.

Business operations

If it's relevant to your business — for example, if you're a manufacturer or if you service products — also provide information about your facilities or physical plant or infrastructure, your equipment and methods of operation, and your materials and supplies and their sources.

Supplying Financial Information

In the finance section of your business plan, you're going to crunch the numbers to show you've got a good chance of making a profit, or at least of paying back the loan or generating a return on the investment. This is a spot where lenders or investors will become extremely eagle-eyed, because they want to be pretty sure they'll get their money back someday, one way or another.

You do this part of the business plan through spreadsheets (financial tables) rather than written text.

Specifically, investors will want to know

- **How much money the business needs to get up and running** (or to expand, if this isn't a start-up operation) — in other words, what the present capital requirements of the business are.
- **How many assets and liabilities the business already has —** how much property it owns, such as money, accounts receivable, real estate, equipment, and valuable contracts such as licence agreements and leases, and how much it owes, such as mortgages, loans, and accounts payable. This is the balance sheet.
- **What the projected profit of the business is —** how much the business will earn and how much it will cost the business to earn that amount. Or to put it another way, what the revenue and operating expenses will be (this is a statement of revenue and expenses). You may also have to show when the revenue comes in and when payment of expenses goes out with a cash flow statement.
- **What assets and liabilities the principals of the business have —** this means preparing a personal balance sheet for each owner of the business. A loan for your business will actually be a personal loan if your business is a sole proprietorship or a partnership. And even if your business is a corporation, chances are good you'll be asked to guarantee a business loan personally if your business doesn't generate enough profit and doesn't have enough assets to sell to repay the loan. If you're not a good loan risk personally, the whole deal may fall through.

If your business has been in operation for two or three years and isn't a start-up, you'll also be expected to provide balance sheets for the preceding years and income (or profit and loss) statements. See Chapter 4 for more about these statements.

Capital requirements of your business

We talk about calculating the capital requirements of your business in Chapter 1, which provides a table that helps you to prepare a statement of your start-up capital needs.

Assets and liabilities of your business

The assets and liabilities of your business are set out in a balance sheet. In Chapter 4, we explain balance sheets and how to prepare them.

Projected revenue and expenses of your business

We talk about preparing a forecast of revenue and expenses in Chapter 1, and we provide a table there to help you work out your forecast of revenue and expenses for the first year of business.

Your personal capital

The lender or investor may well be looking to you to pay up if your business can't. If so, you'll be asked to provide a personal balance sheet, often called a statement of net worth, listing your own assets and liabilities. This provides a snapshot of the financial you. Table 2-1 shows an example of a personal balance sheet, where we recommend you present assets in order of liquidity, or how quickly they can be translated into cash.

Table 2-1 Personal Balance Sheet

Assets:	
Cash	$
Investments	$
Cash-value life insurance	$
Real estate (home, cottage)	$
Vehicles	$

Assets:	
Personal property	$
Personal loans	$
Other	$
TOTAL ASSETS	**$**
Liabilities:	
Mortgages	$
Personal loans	$
Credit card balances	$
Other personal debts (for example, unpaid property taxes, unpaid income taxes, outstanding bills, child support)	$
TOTAL LIABILITIES	**$**
NET WORTH (total assets minus total liabilities)	$

Providing References

You're exhausted now, but you're not finished. As a final touch, a lender or investor might like to know more about your business reputation (or, if you don't have a business reputation yet, your personal reputation) — but not from you. So be prepared to provide, if asked, the names of two or three people the lender or investor could speak to — for example, your bank or credit union loans officer or branch manager if you've dealt with him or her for some time, or other businesspeople you've dealt with over the years (probably best not to name your competitors . . . or your mother . . . here). If you've never been in business for yourself before, you could name an employer or a customer or client you worked with. Ask your references for permission before you give their names. At the very least, you don't want them to be taken by surprise when a lender calls up for a chat about you.

If your business venture revolves around marketing a new technology (say, new computer software or hardware), a lender or investor would probably like to have the names of a couple of people who know the field and who can give an opinion about the commercial potential of your technology. Again, avoid giving the name of a competitor.

Pulling the Final Product Together

After you've put together a first draft of your business plan, ask someone with business experience whose judgment you trust to read the plan and comment on it. Then revise the plan and polish up the prose. Your final version of the plan will include the following:

- Cover
- Title page
- Table of contents
- Executive summary
- The plan itself
- Financial statements
- References
- Sources for industry statistics

Cover

For the cover of your business plan, don't get carried away with something expensive or covered with decorations. Just buy a plain paper cover — preferably in a conservative colour.

Executive summary

If your plan is more than three or four pages long (excluding financial charts), provide a summary at the beginning of the plan so the reader can decide even more quickly whether to talk to you or to simply toss your plan in the circular file. The summary should

- State the amount of money you require and what you will do with it.
- Briefly describe your business.
- Describe your business's product or service.
- Summarize your income projections.

Chapter 3

Paying Your Dues: All about Taxes

In This Chapter

- Getting comfortable with income tax
- Finding out about sales taxes
- Revisiting payroll taxes
- Looking at other business taxes

One of the unpleasant realities of being in business is that you are expected to pay taxes. Every level of government — federal, provincial, and municipal — wants something. You have to pay

- **Income taxes** — to the federal and provincial governments
- **Sales taxes** — to the federal and provincial governments
- **Payroll taxes** — to the federal and provincial governments
- **Business taxes** — possibly to the federal and provincial governments, and more likely to your municipal government

Taxes not only are hard to dodge, but also are complicated and difficult to understand. We can't explain taxes fully in just one chapter. In fact, you can still be pretty muddled (not to mention shell-shocked and bored within an inch of death) after reading whole books about taxes. So in this chapter we give you just enough information to let you know the kinds of taxes you have to pay and when you have to pay them, and we throw in a bit of advice about keeping your income tax to a minimum. (We purposely left out property taxes, assuming your young business might not own real estate — yet!)

Income Taxes

Individuals and corporations must pay taxes on income to both the federal and provincial governments. The Canada Revenue Agency (CRA) collects both federal and provincial income taxes from individuals (human beings,

that is) in every province except Quebec, and from corporations in all provinces except Alberta, Ontario, and Quebec, where the provincial governments collect their own corporate income taxes.

A business can also be taxed on its capital gains. A capital gain is the profit made on the sale or other disposition of capital property. Capital property is property acquired to be held on to rather than resold right away. Examples of capital property could include commercial real estate bought for use in a business, or shares in a corporation. A start-up business isn't likely to have capital gains while it's a going concern, so we don't talk about capital gains in this chapter. But a business may have capital gains or capital losses when the business is sold or is wound up.

What income is a business taxed on?

You will be pleased to know you're not taxed on every cent your business earns. Your income taxes are calculated only on the *profit* your business makes. Your business's profit is its gross income (or revenue — the money the business takes in) minus its legitimate expenses (the money spent or expenses incurred in order to earn the income).

The lower your business's profit, the less tax you will have to pay. So the question is how legally to keep your profits as low as possible for tax purposes. Two fundamental ways to have low profits (and therefore low taxes) exist. One is to keep your business revenues as low as possible and the other is to make your legitimate business expenses as high as possible.

Unfortunately, you can't minimize your business revenue without cheating because you are required by law to report everything your business earns. So the only way to legally reduce your profits and your tax payable is to maximize your legitimate business expenses. Over the next few pages, we tell you what is considered to be business revenue and what is considered to be a legitimate business expense.

Everyone wants to pay as little tax as possible. Tax *avoidance* is paying as little tax as is legally possible. That's cool. Tax *evasion,* on the other hand, is failing to pay taxes that are legally owing — and it's a crime. That is so *not* cool. Income tax laws are complicated and change constantly, so you need expert tax advice from a qualified or professional accountant and/or tax lawyer to make sure you avoid as much tax as you can without evading any tax. You also need advice to make sure any tax-avoidance scheme you come up with will actually work.

What is business revenue?

According to the CRA, business revenue includes money earned or valuable property received from any activity you engage in as part of your business. Business revenue includes

- Fees charged to your clients for services you provide, excluding any sales tax you charge
- The purchase price charged to your customers for goods you sell, excluding any sales tax you charge

You are required to report to the CRA all revenue earned by your business during the taxation year.

What are legitimate business expenses?

The CRA allows you to deduct from business revenue most reasonable expenses you pay in order to earn that revenue. Because, as we mentioned, the only legal way to reduce your profits — and therefore your taxes — is to maximize your legitimate business expenses, it's very important to know what your legitimate business expenses are. They include

- Mortgage interest and property taxes on real property you own and use *for your business* (see the heading "Home office expenses" if you run your business out of a home you own)
- Rent if you lease your business premises (see "Home office expenses" if you run your business out of your rented home)
- The cost of labour and materials for any repairs or maintenance done to that portion of your property used to earn income
- The cost of leasing equipment used in your business
- The cost of buying or manufacturing the goods you sold during the year
- Delivery, freight, and transportation expenses
- Business insurance premiums you pay to insure any buildings, machinery, inventory, and equipment you use in your business
- Utilities such as telephone, Internet, electricity, heat, and water attributable to your business activities
- The cost of office expenses and supplies — small items such as printer ink cartridges, stationery, pens, pencils, paper clips, and stamps

- Some of the expenses of running a motor vehicle you use to earn business revenue (for more information see the heading "Car expenses")
- Interest you pay on money you borrow to run your business
- Annual licence fees and levies (such as municipal business taxes) to run your business
- Annual dues or fees for membership in a trade or commercial association (but not if the main purpose of the club is dining, recreation, or sporting activities)
- Legal, accounting, and other professional fees
- Management and administration fees to operate your business, including bank charges
- Expenses for advertising your product or service
- Travel expenses incurred to earn business revenue
- Fifty percent of business meals, beverages, and entertainment attributable to your business
- Salaries and benefits you pay to employees, as well as your portion of Canada Pension Plan and Employment Insurance premiums (see the heading "Employee salaries" for more information)

You may have noticed that in this list we mention only leased equipment, and purchased office supplies of a minor kind such as pens and paper. More important items that you purchase (rather than lease) — such as a computer, phone system, fax machine or other office equipment, furniture, and larger items such as buildings or vehicles — can't be fully claimed in the year of *purchase* as a business expense. That's because these items, which are capital property, will continue to be useful to your business for more than one taxation year. However, because these items *depreciate* (wear out or lose their usefulness over time), you can claim a percentage of the cost as a business expense each year spread over a period of several years until the entire cost has been claimed. The amount you are allowed to claim on depreciable capital property each year as an expense is called capital cost allowance, and a special place on the income tax form lets you calculate the exact amount of capital cost allowance you can claim in a given year.

Many of your business expenses are clearly only for your business, such as the cost of an ad in the newspaper or lease payments on machinery used to create the product you sell. But you may use other items both for your business and personally — for example, a cell phone, a computer, or your car. When you calculate your business expenses, you are not allowed to claim any part of the expense that relates to your personal use of the item. You can

deduct only the portion of the expense that relates to your business use. For example, if you use half your monthly airtime on your cell phone for business calls and half for personal calls, you can claim as a business expense only the amount paid for the business calls.

Home office expenses

If you operate your business from your home, you're allowed to deduct expenses for the business use of your home. This allows you to get a tax deduction for a portion of your home expenses (which you would have to pay anyway).

For the costs to be deductible, your home office must be your main place of business. If it's not your main place of business, it must be used exclusively for business purposes and be used on a regular basis for meeting clients or customers in connection with the business.

If your home office meets one of these two tests, you can deduct a percentage/portion of the following costs:

- Mortgage interest and property taxes (if you own) or rental payments (if you rent)
- Utilities such as heat, electricity, and water
- Maintenance costs or condo fees
- Home insurance

To figure out the percentage you're allowed to deduct, calculate what percentage of your home you use for your business. Divide the area of your office by the total area of your home. So, for example, if your home is 1,500 square feet in area, and the room you use exclusively for business is 300 square feet in area, then you can deduct 20 percent of your home costs. Or you may divide the number of rooms occupied by your business by the total number of rooms in your home. For example, if you have four rooms in your apartment and you use one of those rooms exclusively for business, then you can deduct 25 percent of your home costs. The key point to keep in mind is that your calculated percentage must be reasonable. If it is in fact reasonable and supportable, you should be fine with the CRA police!

You can use the home office deduction to bring your business revenue down to zero, but not to put your business into a loss position, or to increase a loss that already exists. When you reach zero, any home office expenses left over can be applied against business revenue in future years.

Car expenses

You are allowed to deduct the expenses of running a motor vehicle you use to earn business revenue. These expenses include

- Fuel and oil
- Maintenance and repairs
- Insurance
- Licence and registration fees
- Leasing costs or interest paid on money borrowed to buy the vehicle (but note that if your vehicle is a passenger car, a limit applies to the amount you are allowed to claim)
- Capital cost allowance, if you own the motor vehicle (again, if your vehicle is a passenger car, a limit applies to the amount you are allowed to claim)

If you use your car for both business and personal purposes, only the portion of your car expenses that relates to your business activities is a legitimate business expense. Use the following formula:

$$\frac{\text{Total car expenses} \times \text{kilometres driven for business purposes}}{\text{Total kilometres driven}} = \text{Allowable business expense}$$

Employee salaries

You can deduct the salaries you pay to your employees, as well as the portion you pay of their Canada Pension Plan and Employment Insurance contributions. You can also deduct the cost of any benefits you provide to your employees, such as health insurance and life insurance.

Hiring a family member may be a good way to reduce your business income taxes. By paying your spouse or child or parent a salary, you reduce profits/income and therefore taxes payable. Your family member will have to pay tax on the salary, but will pay less tax than you or your business would as long as his or her tax rate is lower. By shifting some of the profit to your family, you increase your family's after-tax income even though total income remains the same.

You can employ family members in your business and deduct the salary as a legitimate business expense if

- You actually pay the salary.
- The family member actually does work that is necessary for the business.

- The salary you pay is reasonable in comparison to what you would pay someone else.

If you are a sole proprietor or a partner, you or your partners are not employees of the business so you cannot deduct any salary or draw taken. In order to be employees and run the business, you have to incorporate. However, other tax advantages to being a sole proprietor or partner exist, so don't go rushing off to incorporate.

How much tax will you pay?

The amount of tax you will pay depends on the form of your business. That's because sole proprietorships and partnerships are taxed differently than corporations.

If your business is a sole proprietorship or partnership

If you carry on business as a sole proprietor, from the tax point of view the business's income is considered to be your personal income. If you carry on business in a partnership, your share of the business's income is also considered to be your personal income. These are key concepts to remember.

You report your (or your share of the) business's profits or loss in your personal income tax return. (See the heading "When and how do you have to pay?" for more about how this is done.) Your business does not file a separate tax return.

If your business has made a profit, the profit (or your share of the profit) is included in your personal income and is taxed as personal income. If your business has suffered a loss, the loss (or your share of the loss) is subtracted from your personal income from other sources for the year. That means a business loss reduces your total income.

If you have a business loss but you have no other income for the year, or if the loss from your business is greater than your income from other sources, you can carry the loss back and apply it against income you earned in the past three years, or you can carry it forward and apply it against income you earn in the next seven years.

Your federal and provincial income taxes are calculated as a percentage of your total personal income, including your business profit or loss. Your tax rate depends on your total income — as your income goes up, so does the percentage at which it is taxed.

Federal tax rates are the same across the country, but provincial tax rates vary from province to province. As a result, the combined rates of federal and provincial taxes vary across the country. You can find exact information about the combined federal and provincial taxes for your province at KPMG Tax Services at `www.kpmg.ca/en/services/tax`. You can also find other tax-planning tips from KPMG by navigating to its home page at `www.kpmg.ca`.

If your business is a corporation

If your business is incorporated, the corporation is a taxpayer and has to file its own income tax return (see the heading "When and how do you have to pay?" for more about how this is done) and pay tax on its profits.

Unlike individuals, whose tax rate increases in steps or brackets with the amount of income earned, corporations are taxed at a flat rate. Depending on the province, the combined federal and provincial tax rate ranges from about 30 to 37 percent. However, the federal small business deduction reduces the tax rate to between 14 and 20 percent on the first $400,000 of business income earned by a Canadian-controlled private corporation. (A Canadian-controlled private corporation is exactly what it sounds like — a private corporation controlled by Canadian shareholders.) In some provinces, the tax rate on a Canadian-controlled private corporation's business income over $400,000 ranges between 23 and 27 percent (depending on the province).

The small business deduction generally does not apply to a corporation's income from interest, dividends, rents, or royalties.

If your corporation suffers a loss, the loss can be carried back and applied against profits made in the past three years, or carried forward and applied against profits made in the next seven years. (The corporation's loss cannot be applied to reduce your personal income for tax purposes.)

The tax authorities aren't finished with you after they tax your corporation. If you receive any money from the corporation in the form of salary, benefits, a bonus, or dividends, you have to report that money as income on your personal income tax return and pay tax on what you receive. (See the heading "If your business is a sole proprietorship or partnership" for tax rates.) Salary, bonus, or benefits are taxed at your personal tax rate. Dividends are also taxed at your personal tax rate, but come with a dividend tax credit that limits the tax to a maximum of about 36 percent (the figure varies by province). The tax credit recognizes the fact that dividends are a distribution of corporate profits on which the corporation has already paid taxes.

When and how do you have to pay?

Every Canadian taxpayer is required to file an income tax return each year and pay whatever taxes are owing. The type of return you file, your deadline for filing it, and the deadline for paying your taxes depend on your form of business organization.

If your business is a sole proprietorship or partnership

If you carry on business as a sole proprietor or in a partnership, your profit from the business is considered to be your personal income and is reported in your personal tax return — the standard T1-General Form. Your business does not file a separate tax return. Instead you complete a Form T2124, Statement of Business Activities (or T2032, Statement of Professional Activities, which looks much the same), and include it as part of your personal tax return. The form gives details of your business's revenue and expenses. You include the business's profit (or loss) as part of your income.

Individual taxpayers must file their personal income tax returns and pay any taxes owing by April 30 of the year following the taxation year. (That means, for example, filing your income tax return for 2008 by April 30, 2009.) If you are self-employed and are a sole proprietor or a partner, your tax return is not due until June 15 following the end of your business's fiscal period or taxation year (which for most partnerships and sole proprietorships must be the same as the calendar year). However, your taxes must still be paid by April 30. So even if you're not ready to prepare your income tax return, you have to estimate how much tax is owing and send in that amount by April 30 with a letter setting out your social insurance number and what the payment is for. (If you estimate wrong, you'll have to pay interest from April 30 on the amount you didn't pay but should have.)

Don't for a minute think that just because you are self-employed and not receiving a paycheque the CRA will sit back and wait to be paid all the taxes you owe on April 30. Self-employed taxpayers are required to pay their tax by quarterly instalments. After your first year of making a profit on which you have to pay at least $2,000 in tax, the CRA will send you an instalment notice telling you that you have to start paying taxes on a quarterly basis, and thereafter it will send you quarterly reminders to pay up. The CRA calculates your instalment payments, but you don't have to pay those amounts. You can estimate your income for the year and pay one-fourth each quarter. But if you underestimate the amount of tax you owe, you will have to pay interest on the amount by which your instalments fall short.

If you have to make quarterly instalment payments, salt away in a special bank account the amount you'll owe at the end of each quarter, so that you don't accidentally spend it.

In the first year your sole proprietorship or partnership makes a profit, don't forget you're a taxpayer even though you don't have to pay taxes until April 30 of the following year! Estimate (generously) how much money you'll owe in taxes on each month's income, and put that amount into an interest-earning bank account or into Treasury bills or GICs so you'll have it ready to pay on April 30. Doing this will earn some interest income on it.

If your business is a partnership with six or more partners, the partnership must also file a partnership information return — Form T5013. (An information return is not a tax return. It is not used to calculate how much tax is payable, but to give the CRA information to ensure tax information for the partnership is being properly calculated and reported by each of the partners.) The partnership information form must be filed by March 31.

If your business is a corporation

If your business is incorporated, the corporation is a taxpayer and has to file its own income tax return — Form T2, Corporation Income Tax Return — together with information from the corporation's financial statements. (See Chapter 4 for more about financial statements.) Form T2 serves as both a federal and provincial income tax return — except in Alberta, Ontario, and Quebec, where a separate provincial corporate tax return must also be filed.

The corporation will have to file a corporate income tax return within six months after the end of the corporation's fiscal period or taxation year. Unlike a sole proprietorship or partnership, a corporation can choose any date for its year-end.

You will also have to file your personal income tax return. Your return must be filed by April 30, because you are not considered to be self-employed when you're running your business through a corporation.

A corporation must pay income tax in monthly instalments unless the tax payable for the year or for the previous taxation year is $1,000 or less. (During the corporation's first taxation year, no instalment payments have to be made.) The CRA does not calculate the amount of the instalments — you must do that yourself, basing your payment on one of the following:

- An estimate of the tax payable in the current year
- The tax paid in the previous year
- A combination of the tax paid in the previous year and in the year before that

If the corporation owes more income tax than it paid in its monthly instalments, it must pay the balance within two months after the end of the corporation's fiscal year (three months if the corporation is a Canadian-controlled private corporation, eligible for the small business deduction, and with an income of less than $300,000). Notice that the due date to pay the balance of the tax is earlier than the deadline for filing the corporation's income tax return.

If you've engaged in conduct

Whether your business is a sole proprietorship, partnership, or corporation, if you don't make your instalment payments on time, don't pay enough in instalment payments, or don't pay any balance of tax owing by the due date (April 30 for individuals, and two [or three] months after the fiscal year end for a corporation), then you will have to pay interest at about 10 percent on taxes that are overdue.

You may have to pay a penalty if

- Your accumulated interest charges for any year are more than $1,000.
- You file your income tax return late.
- You fail to report income.
- You knowingly or carelessly make false statements or omissions on your tax return.

Penalties start at 5 percent of unpaid taxes . . . but they don't stop there.

What records must you keep?

Any corporation or individual who carries on a business, or is required to pay or collect income taxes, must keep books and detailed records that allow the amount of taxes payable to be calculated and checked. You must hold on to these books and records for at least six years after the taxation year they relate to.

To make it easier to prepare your tax returns when they are due, keep organized books and records throughout the year and hang on to your invoices and receipts. You can keep actual account books, or you can use small-business bookkeeping and accounting software. We tell you more about accounting for your business in Chapter 4.

What if you're audited?

When you file your or your corporation's income tax return, it is reviewed by the CRA. When the CRA completes the review, it issues a notice of assessment, which sets out the amount of tax payable for the year. The CRA has the right to reassess your return later, and can go back and reassess your returns for the past three years (or longer, if they suspect fraud) and ask you for more money. If you disagree with the CRA about the amount it says you have to pay, you (personally or through your accountant) can object to the assessment or reassessment, and try to persuade the CRA that you don't owe as much as they say by showing them documents that support your objection and even by visiting the local Tax Services Office in person to argue your case. This can go on for some time, because the CRA usually takes a while to digest any communication from a taxpayer.

A tax audit is different from (and worse than) an assessment or reassessment. In an audit, the CRA goes over all your records, including records you weren't required to send in with your tax return, to see whether you've declared all your income and deducted only legitimate expenses.

Tax returns of corporations and of self-employed taxpayers are more likely to be audited than those of taxpayers who are employees, because businesses have more opportunities to evade taxes by hiding income or inflating (or even making up) expenses.

On an audit, you will have to prove all your income and expenses by presenting receipts. So, just in case you're audited, keep receipts that are dated and show what business activity they relate to.

If you are audited, the CRA will notify you by letter that your tax return for a stated year, or years, has been selected for review. The letter will ask you to provide specified information within 30 days (although you can ask for an extension if you need more time).

If you get an audit letter, speak to your accountant immediately. If you don't already have an accountant, this would be a good time to get one! You can respond to the request on your own, or you can (and probably should) hire an accountant or tax lawyer who knows how to handle tax audits.

The auditor will then arrange a face-to-face meeting (your accountant or even your lawyer can be present), during which you may be asked to justify some of your expense claims. You'll respond by showing the tax auditor your supporting records and receipts. Have your records organized so you are able to answer the auditor's questions. Be cooperative and polite, even if you're feeling cranky and angry. (No point in irritating a person who has the power to assess additional taxes, not to mention interest and penalties, against you.)

When the auditor is finished, he or she will send you a letter setting out proposed changes to your income tax return and giving you time either to accept the changes or dispute them. (To dispute the proposed changes, you will have to provide new information that you didn't have for the auditor.) Then the CRA will send you a notice of reassessment setting out what you owe and when it's due.

If you accept the reassessment, you have to pay the balance by the due date. If you can't pay by the due date, you can contact the collections department of the CRA to make other arrangements for payment. You can apply to the Fairness Committee at the CRA to have any penalties or interest set aside. If you disagree with the reassessment, you can file a notice of objection with your local Tax Services Office within 90 days after the date of the reassessment.

Collecting Sales Taxes

You've had the spy-satellite overview of income taxes, so now let's move on to sales taxes.

Sound battle stations! The enemy is performing a flanking maneuver.

The federal government and every province except Alberta require sales tax to be charged when goods are sold or services are provided. The federal sales tax is the Goods and Services Tax (GST). GST and provincial sales tax (PST) are charged separately in all provinces except Nova Scotia, New Brunswick, and Newfoundland, which have combined their provincial sales taxes with the GST into a Harmonized Sales Tax (HST). Provincial sales taxes range from 7 to 10 percent, GST is now 5 percent, and HST is 13 percent.

Provincial sales tax

Businesses that sell goods or provide services on which PST has to be charged are responsible for collecting the tax from the buyer of the goods or services. Businesses are required to *remit* (send) the collected taxes to the provincial government on a regular basis. In every province except Quebec (where sales tax works more like GST; see the "Goods and Services Tax" section), the tax is payable by the final consumer only, so businesses do not have to pay PST on goods that will be resold (although they must pay PST on goods bought for their own use).

If your business will be selling goods or providing services on which PST must be charged, you must register with your provincial government's department or ministry of finance. You will be given a registration certificate and provincial tax number. You will have to file periodic (usually monthly) returns with the ministry of finance, in which you report the amount of tax collected and remit the tax. For more information about PST in your province, check the Web site for your provincial Canada Business Service Centre or for your provincial government.

Your business must keep proper books and records to document the amount of tax collected, and you are subject to audits by the provincial government.

If you fail to file returns, collect taxes as required, or remit the taxes collected, you may be charged an interest penalty. You may even be charged with an offence and be hauled into court.

Goods and Services Tax

GST applies to almost all goods sold and services supplied anywhere in Canada. Unlike PST, which is paid only by the ultimate consumer, GST is charged to everyone along the production and sale chain — from the supplier of the raw materials, through the manufacturer, wholesaler, and retailer, down to the consumer. While everyone is charged the tax, the government keeps only the tax paid by the ultimate consumer. Everyone else in the chain is allowed to claim a refund on the GST they paid (called an input tax credit).

You'll find plenty of information about the GST on the CRA Web site at `www.cra.gc.ca`.

GST categories

GST must be charged when goods and services are "supplied" — whether by sale, rental, barter, or gift. Three categories of "supplies" exist:

- Supplies that are taxable at 5 percent, which include all supplies that don't fall into the second and third categories — so chances are good that whatever goods or services you're providing are in the first category
- Supplies that are taxable at 0 percent, which include prescription drugs and medical devices, basic groceries, international travel and transportation, precious metals, and farm and fishing products and equipment
- Supplies that are tax-exempt, which include health care, personal care, child care, or educational services and financial services

Are crazy people running the Goods and Services Tax department of the federal government? Why would you tax supplies at 0 percent . . . and what on earth is the difference between supplies that are taxed at 0 percent and supplies that are tax-exempt? Well, the GST people may indeed be crazy, but a certain method to their madness does exist. The supplier doesn't collect GST from customers if supplies are taxed at 0 percent or if supplies are tax-exempt. But if a business provides zero-rated supplies, it can still claim a refund on the GST it paid to get goods and services, whereas if a business provides tax-exempt supplies, it can't.

Registering for the GST

If your business provides GST-taxable goods and services and has annual revenues of more than $30,000, you *must* register for the GST. Otherwise you *may* register. After you register for the GST, you must charge GST to your customers and remit it to the CRA, and you can claim a refund on the GST you pay to get goods and services. If you don't register for the GST, you don't have to charge GST, but you can't claim a refund, either.

Register for the GST even if your revenues are less than $30,000. You'll be able to get back the GST paid on the goods and services your business buys. Besides, you don't really want your customers to know that your business's annual revenues are less than $30,000.

You register for the GST by applying to the CRA for a business number.

Collecting and remitting GST

When you invoice a customer or client for goods or services you provide, you have to invoice for GST, as well. You calculate GST on the full price your customer pays, including any customs or excise duties and transportation taxes — but excluding any provincial sales tax, and not taking into account any discounts for early payment of your invoice or interest charged for late payment.

You must report the amount of GST collected and remit it to the CRA on a regular basis. How often you remit depends on your business's annual sales, as follows:

- If your annual sales are less than $500,000, you must remit GST quarterly, and you must report annually, although you can choose to report quarterly; you can also choose to report and remit monthly.
- If your annual sales are between $500,000 and $6,000,000, you must report and remit GST quarterly, although you can choose to report and remit monthly.
- If your annual sales are more than $6,000,000 (here's hoping!), you must report and remit GST monthly.

On the GST form, you show the GST that your business charged on the goods and services it provided, as well as the GST that your business paid on the goods and services it bought. The difference between what you charged and what you paid is the amount you must remit to the government. If you paid more than you charged, you are entitled to a GST refund.

You must keep books and records, including invoices, to document the GST collected and any refunds claimed, for six years.

If you fail to report or remit GST as required, you will be charged interest and penalties. If you willfully fail to pay, collect, or remit GST, you can be charged with an offence, and if you're convicted, you can be fined or imprisoned.

Harmonized Sales Tax

Hey, what's that sound? Could it be "The Ride of the Valkyries"? Actually, it's the humming of the Harmonized Sales Tax (HST), the name given to the combined GST and provincial sales tax charged in Nova Scotia, New Brunswick, and Newfoundland.

If your business supplies goods or services in these provinces, no matter where in the country your business is actually located, you are required to collect and remit 13 percent HST to the CRA. When you register for GST, you're also registered for HST, which works the same way as GST.

Payroll Taxes

Payroll taxes are taxes levied by the federal government and some provincial governments on businesses with employees. The federal payroll taxes are Employment Insurance (EI) and Canada Pension Plan (CPP). Employers must make contributions to EI and CPP on behalf of their employees, as well as withhold and remit the employees' contributions. Provincial payroll taxes include health insurance and workers' compensation premiums.

Business Taxes

In addition to income taxes, sales taxes, and payroll taxes, federal, provincial, and municipal governments levy other business taxes:

- The federal government levies a large corporation tax on corporations with over $10 million of taxable capital in Canada.

- Some provincial governments levy a tax on the paid-up capital of corporations. Paid-up capital is the total amount paid to the corporation for all the shares that have been issued to shareholders.
- Municipalities levy taxes on businesses. Businesses that own real estate in the municipality have to pay property taxes, but in some municipalities even businesses that rent rather than own are required to pay taxes. These taxes may be based, for example, on the annual rental value of the property, on the square footage of the premises, or on the value of the business's stock-in-trade.

Your accountant can tell you more about these matters, or you can contact your federal, provincial, and municipal governments or visit their Web sites.

Chapter 4

Close Encounters with Accounting

In This Chapter

- Understanding why accounting is important for your business
- Looking at the basics of bookkeeping
- Finding out what records to keep and how to keep them
- Getting acquainted with financial statements

To be successful, a small business owner has to keep track of what the business earns and what it spends, and what it owns and what it owes. That means every small-business owner has to know something about accounting. Accounting is essentially a key *language* of business. But we're not going to inflict an entire accounting course on you (we are not that cruel and unusual) — we're just going to tell you about the absolute basics. If you find yourself yearning for more information than we provide here, you can turn to *Accounting For Canadians For Dummies* (Wiley).

What's Accounting and Why Is It Important?

The essence of accounting is keeping track of financial transactions. Accounting is a process that begins with the collecting and recording of information about transactions and continues with the sorting of the transactions by category and ends in the preparation of financial statements and income tax returns. Accountants call this process the accounting cycle. Some of the steps in the accounting cycle will be carried out by you, others will be carried out by your bookkeeper and/or your computerized accounting system, and still others will be carried out by your accountant.

Accounting is important in the day-to-day operation of your business because it helps you

- Collect your accounts.
- Pay your bills.
- Pay your taxes.
- Keep track of your inventory.
- Prevent theft and fraud by your associates, employees, and customers.

Accounting is also important in the long term because it helps you

- Assess how your business is doing.
- Collect the information you need to plan and make decisions.
- Give lenders the information they want before they will lend you money.
- Give investors the information they want before they will invest in your business.
- Make financial forecasts and develop budgets.
- Give a buyer the information he or she wants to see before buying your business.

Starting with Bookkeeping

Bookkeeping is the information-gathering and record-keeping aspect of accounting. No matter how much professional or computer help you intend to have with your bookkeeping, keeping track of all the financial transactions of your business is up to you — such as making sales, buying inventory, paying salaries, and borrowing money.

Your first chore as a bookkeeper is to keep all the pieces of paper, such as invoices, sales slips, and credit card slips that document business transactions (and the more organized you are about it, the better). Keep a record of these transactions.

Saving pieces of paper

Every financial transaction of your business should be documented by a piece of paper.

- **Generate an invoice whenever your business provides a service or sells a product.** You may have the kind of business where you prepare

invoices only on a weekly or monthly basis. Most accounting software can generate invoices. If you're in a retail business, your cash register may generate a sales slip or invoice when you ring up the sale, or you may have to write up an invoice by hand. Send or give the invoice to the customer or client, and keep a copy for your records.

- **Get a bill, invoice, or receipt whenever your business incurs an expense or makes a payment.** We mean every payment, no matter how small! If it's not clear what the receipt relates to, or the date the payment was made, make a note on the receipt identifying the transaction more clearly.

  For income tax purposes, you have to keep a copy of both the bill and a copy of your cheque as proof of payment.

You must save every last one of these pieces of paper, which accountants and bookkeepers refer to as *source documents*. You can just throw all of them into a file, and let your bookkeeper and/or accountant sort them out later (and charge you for the extra work), but it makes more sense for you to set up some sort of system for filing them by category. For example, you may want to set up separate files for

- Invoices you give to your customers when you provide a service or product
- Inventory purchases
- Office supply expenses
- Car expenses
- Entertainment expenses
- Accounting expenses

Recording your transactions

The next step in the bookkeeping process is to make a written record of the financial transactions, taking the information from your source documents.

Open a business bank account

If you want to keep track of and have a record of your business transactions, open a bank account that is just for your business. Open a separate account even if your business is a sole proprietorship or partnership. (If you're a sole proprietor or partner, your business is not legally separate from you as an individual.) You might think it doesn't matter if your business and personal accounts get mixed up — but after we get finished with you in this chapter, you'll come around to our point of view that it's best to keep your business affairs to themselves.

The bank account should be a chequing account that gives you a monthly statement and that automatically returns your cancelled cheques. Unless you will be using a computerized accounting program that will prepare and keep track of your cheques (see later in this chapter), order cheques for your new account and get a cheque register. (This little booklet for recording transactions in your account usually comes with your new cheques or can be wheedled out of a teller at your bank or trust company.)

Pay into and out of your business account

Whenever you receive a payment for goods or services provided by your business, deposit the entire amount immediately in your business account. Enter the payment received in your cheque register.

As much as you possibly can, make any payments for your business by cheque. If you like to make payments by credit card, consider getting one card you use for nothing but business purposes. Always pay your monthly bill for that card out of your business account.

If you have just one credit card for both personal and business purposes, you can pay the monthly bill out of your personal account and then write a cheque to yourself on your business account for the business portion of the bill. On the cheque stub for the total repayment, make a note of the individual amounts and the supplier's name — that way your accountant (or your auditor) won't have to go through your personal records to verify your expenses. Similarly, if you happen to make a cash payment out of your personal pocket for a business expense, write yourself a cheque on your business account to repay yourself.

Whenever you make a payment, enter it in your cheque register.

If you operate this way, you automatically create a record of all your business's revenue and expenses. In accounting language, you are recording entries into a cash receipts and cash payments journal.

Cash accounting or accrual accounting?

When you record a business transaction in your cheque register, you are not recording the transaction until you actually make or receive a payment. This is called *cash accounting* — you record income when you actually receive it and expenses when you actually pay them.

Cash accounting is an accounting method. An accounting method is supposed to match up your revenue and expenses in a consistent way. Accrual accounting is another accounting method.

In *accrual accounting,* you record revenue when you earn it (when you send out an invoice for the service performed or product supplied — this is one of

the most common of several possible triggers of revenue recognition), and you record expenses when you incur them (generally when you receive a service or product). You'll actually receive the income or pay the expenses at some later time.

When you choose an accounting method, you generally do not change back and forth.

Speak to your accountant about whether to use cash accounting or accrual accounting in your business. Service providers usually use the cash method, while retailers usually use the accrual method. You will have to report your business revenue on an accrual basis for income tax purposes.

If you use accrual accounting in your business, you will have to keep another set of records to record sales when you make them (called a sales journal) and purchases when you make them (called a purchases journal).

Sorting your revenue and expenses by category

The next step in the accounting cycle is to sort your business's financial transactions into categories. You need to know what categories your revenue and expenses fall into in order to prepare your income tax returns and financial statements, and in order to keep track of how your business is doing and to make decisions and plans.

Sorting your revenue

All money your business receives is not identical. For example, when you receive a payment from a customer or client, most of it will be payment for your product or service, but some of it will be payment of GST/HST and/or provincial sales tax.

Your business may receive other kinds of money as well, such as

- Advances from the bank under a loan to your business
- Refunds for goods your business has purchased and returned
- Payment from an insurance policy for losses your business has suffered
- Refund of a security deposit given when you entered into a lease
- Money you or your family invest in the business

You need to sort revenue by category, because different kinds of revenue are treated differently in preparing financial statements and for tax purposes.

Sorting your expenses and other payments

You also need to sort your expenses and other payments by category, because different kinds of expenses are treated differently in preparing financial statements and for income tax purposes. (See Chapter 3 for more about expenses and tax deductibility.)

Some of the categories of expenses you will want to keep track of are:

- **General expenses to run your business:** These expenses include things such as:
  - Rent
  - Interest on borrowed money
  - Legal and accounting fees
  - Office supplies
  - Professional or trade association fees
  - Wages paid to employees (including deductions)

  These operating expenses are fully deductible from income in the year the expense occurred. They are sometimes called overhead.
- **Costs incurred to produce a product you manufacture:** These costs are fully deductible from income in the year the cost occurred too, but they show up in a different place on financial statements, so you might as well stick them in a different category from the beginning.
- **Inventory:** The cost of buying inventory is also fully deductible from income, but it too has a special place on a financial statement.
- **Auto expenses:** If you use a vehicle partly for business purposes and partly for personal purposes, only the business portion is deductible. Keep auto expenses separate from other expenses so you can calculate the deductible portion at the end of the year.
- **Home office expenses:** You can deduct only a portion of your home rent or mortgage and utilities if you're running your business out of your home. So keep these expenses separate from other business operating expenses.
- **Business entertainment:** Only 50 percent of a business entertainment expense is deductible from revenue, so don't just toss it into the general expense pile.
- **Capital purchases:** These are purchases of capital property, which is property with a long-term value, such as equipment, vehicles, and furniture. You can't deduct any portion of a capital purchase in the year of

the purchase, and after that you can deduct only a specified percentage as capital cost allowance (also known as depreciation). So definitely don't let your capital purchases get mixed up with your operating expenses. (See Chapter 3 for more about capital cost allowance.)

- **GST/HST payments:** Keep track of the amount you pay for GST/HST separately, so you can incorporate input credits into your calculation of how much you owe at the end of each quarter.

In accounting language, these categories are called *accounts*.

Record keeping

To sort your revenue and expenses by category, keep separate records for the different types of revenue received by your business and the different types of expenses incurred by your business. (This is in addition to keeping a cheque register.) Ask your accountant about the categories your business needs to keep track of.

At a minimum, you need different file folders to hold the source documents for each category. But also keep a written record of revenue and expenses. At the most basic level, you could keep these records on sheets of lined paper. At a slightly more sophisticated level, you could keep the records in account books purchased from a business supply store such as Grand & Toy or Staples/Business Depot or Office Place. (Account books are specially lined.) Today, however, most businesspeople use accounting software, which creates the records automatically from the entries you make. Whichever way you do it, the same purpose is served and the same record is created.

Handling the bookkeeping burden

As you can imagine, proper bookkeeping involves a great deal of detailed work. How are you going to get it done? You have three options.

Keep your own books manually

This tried-and-true method is cheap and easy to set up (you can buy manual bookkeeping ledger and journal systems, with directions, from any office supply store), but time-consuming and tedious to maintain.

You have to make all of the journal entries by hand, and then post the changes to the proper accounts. If you need to generate a summary or financial statement, you have to work it out yourself.

If you decide to go this route, ask your accountant to help get you started.

Keep your own books using accounting software

You can use accounting software designed primarily for personal use, such as Quicken or Microsoft Money, or a more sophisticated system designed with small businesses in mind, such as MYOB (Mind Your Own Business), QuickBooks, or Simply Accounting.

The personal-use systems are basically electronic cheque registers, with the added ability to sort expenses into categories and to generate income statements and balance sheets. When you enter your business's financial transaction into the computer, the program will post the changes to the appropriate accounts automatically.

A good business system will also generate sales invoices, track and report GST/HST/PST, track and age your accounts receivable, help keep track of your inventory, and compute employee payroll.

Ask your accountant for advice on the accounting software that's best for your business. Also consider speaking to a computer consultant to make sure you have the computer required to support the software you want to buy, and to ensure the software is installed properly.

Use a freelance bookkeeper

If you can't or don't want to do your bookkeeping yourself, get someone to do it for you. When you first start your business, you probably won't need . . . or be able to afford . . . to hire a full-time bookkeeper. It makes more sense to contract with a freelance bookkeeper who will work only the number of hours your business actually needs.

Your accountant is your best source for finding a bookkeeper. In fact, your accountant probably has a bookkeeper with whom he or she works on a regular basis and who is familiar with the accountant's requirements.

Your bookkeeper and accountant can decide whether to work with a manual or a computerized bookkeeping system.

Practising Inventory Accounting

If you're not in a pure service business, one of the things you want your accounting system to do is to keep track of your inventory so you know when to buy replacement inventory, and also what kind and how much. You need to know what sells and what doesn't in order to know what to buy in the future.

Valuing your inventory

In addition to knowing what you have in your inventory, you need to know how much it's worth. This isn't easy to figure out if you bought identical inventory items at different times and prices throughout the year. (You can't just shrug off this question, because it affects the Cost of Goods Sold figure in your income statement and the Inventory figure in your balance sheet.)

Because identifying your inventory really specifically is impossible, you address this question by using one of two accounting methods. The First In, First Out (or FIFO) method assumes the inventory you bought earliest is sold first. Under this method you value your inventory at the most recent price you paid for it. The Last In, First Out (or LIFO) method assumes the inventory you bought last is sold first. Under this method, the value of your inventory is based on the oldest item in it. Your accountant will advise you which method is right for you. For income tax purposes, you have to use the FIFO method.

The best way to get this information is by using inventory-tracking software. If you have a retail business, you want a point-of-sale system that makes adjustments to your inventory records when sales are entered at the cash register. As we tell you in the section "Handling the bookkeeping burden," some computerized bookkeeping packages include inventory-tracking features. If you prefer a low-tech approach, ask your accountant to help you develop a manual inventory-tracking system.

Whatever system of inventory tracking you use, be sure to do physical counts of your inventory two to four times a year. Compare the results of your physical count with what is shown in your financial records. This will help you identify any inventory theft or loss sooner rather than later!

Monitoring with Internal Controls

Think no one associated with or working for your business will ever stick his or her hand in the till? Think again. Although shoplifting gets more attention, internal theft and fraud cost businesses far more each year. In consultation with your accountant, establish and enforce internal controls, a system of checks and balances, to discourage and detect both honest mistakes and dishonesty. Here are some examples of internal controls:

- Inspecting and counting shipments from suppliers before paying for them
- Requiring two signatures on cheques over a certain amount

- Having outsiders or employees who aren't normally involved do surprise inventories and compare them with inventory records
- Having one person record sales and collections while another person records and takes the deposits to the bank
- Requiring every associate or employee to take a vacation, during which time someone else does that person's job

Historical Financial Statements

The income statement and the balance sheet are the main types of historical statements. You use these statements to track the progress of your business and help you plan for the future.

Creating financial statements

If you have accounting software that prepares financial statements and you've faithfully recorded all your transactions, you can generate accurate financial statements by clicking a button.

It's also perfectly possible to create financial statements by hand. (In the good old days this was the only way to create them.) In the following discussions about income statements and balance sheets, we'll explain the process in case you want to try it yourself — but mainly so you'll have an idea of what's going on inside your computer . . . or your accountant's head.

The income statement

The income statement, also called a profit and loss statement, sets out the business's revenues (or sales) and expenses over a stated period of time (a specific month, quarter, or year). The business's *revenues* are the money that its customers or clients pay for its products or services. Its *expenses* are the costs incurred in doing business. The business's profits or income equal its revenues minus its expenses.

How do you prepare it?

Table 4-1 shows our instructions for preparing an income statement. If you are in a retail or manufacturing business, start with Gross Sales (which is all the money you took in minus GST/HST charged) and then deduct the Cost of

Goods Sold, which is what you paid directly for your inventory, either to buy it or manufacture it — Gross Sales minus Cost of Goods Sold equals Gross Profit. (If you are a service business, you will not have a Cost of Goods Sold expense.) Then set out and add up all your expenses of operating the business other than those directly related to creating or acquiring the product you sell (that's your overhead), and subtract the total from Gross Profit to find your Net Income or (Net) Profit before taxes are taken into account.

Table 4-1 Statement of Revenue and Expenses

Prior Year (Or Month or Quarter)	*Budget (For Current Year or Month or Quarter)*	*Current Year (Or Month or Quarter)*
Revenue/Gross Sales MINUS **Cost of the Goods Sold** EQUALS **Gross Profit**	As a start-up, you won't have a prior year, month, or quarter until you've been in business for a while.	Your budget is the projected statement of revenue and expenses you prepared before the start of this year. See below for forecasting revenue and expenses. These are the actual figures from the records you've kept for the period.
Expenses (such as)		
Accounting/legal, Bank charges, Depreciation, Insurance, Marketing, Rent, Telephone, Wages, Total Expenses		
Net Income or **Profit** (before income tax) (Subtract Total Expenses from Gross Sales or Revenue)		

You prepare a budget for an upcoming period by preparing or considering a forecast of revenue and expenses. It is meant to be a realistic prediction of the revenue you will earn and the expenses you will incur over that period. Before you start your business, your revenue and expense forecasts are based on a combination of research and hope. (It's a lot easier to project your expenses than your revenues before your business is actually up and running. We give you some advice in Chapter 1 about forecasting revenue and expenses.) After your business has been in operation for a year, you'll be able to make your forecasts based on past performance and your knowledge of trends in your field.

What can it tell you?

By comparing the current year's (month's, quarter's) Gross Sales figures to the previous year's (month's, quarter's), you can tell whether your sales are going up or down. By comparing current Expenses to previous Expenses, you can tell which of your expenses have gone up or down. This is called trend and financial analysis, and it's a critical skill you'll need to hone to run your business. Some fundamental areas of analysis follow.

By looking at your Gross Profit or Revenue and Expenses together, you'll see whether you're generating enough through sales to cover your operating costs.

By dividing your Net Income or Profit by your Gross Sales, you'll find out what your return on sales is. That gives you an idea about how efficiently your business turns a dollar's worth of sale into a profit.

By dividing your Gross Profit by total sales made to find your gross profit margin, you can see how much profit you earned on sales before taking into account your costs of selling the products and administering your business.

By dividing your Net Income or Profit by your total sales, you can find your net profit margin or profit margin. A low net profit margin may indicate the business isn't being efficiently run.

The acceptable profit margin varies with the type of business, and you should be able to find out through your professional or trade association what a decent profit margin is for your type of business.

The balance sheet

The balance sheet is a snapshot at a point in time that lists a value for everything a business owns (its assets) and everything it owes (its liabilities) as of a specified date, usually the last date of the company's fiscal (financial) year, referred to as its year-end. It's called a balance sheet because the total assets have to equal the total liabilities (including the owner's equity). (If you come up with a balance sheet where assets don't equal liabilities, you haven't created an imbalance sheet; you've just done it wrong.)

How do you prepare it?

You create a balance sheet by setting down the value of the business's assets and liabilities in a recognized order.

Start with assets, which are categorized as *current assets* or *fixed assets*. Current assets are cash or assets that are intended to be and can be converted into cash easily. Fixed assets are assets the business intends to hold on to for a long period of time.

Then list liabilities, categorizing them as *current liabilities* or *long-term liabilities.* Current liabilities are debts that are expected be paid within a year, such as accounts payable, current wages, current taxes, and the current portion of long-term debt. Long-term liabilities are debts that will not be paid off within a year. *Owner's equity* — what a business is worth after its debts are deducted from its assets — is also considered a liability. (It's that double-entry accounting thing again.) Take a look at Table 4-2.

Table 4-2 Balance Sheet

Prior Year (Month, Quarter)	*Budget*	*Current Year (Month, Quarter)*
ASSETS		
Current Assets		
Cash		
Accounts receivable		
Inventory		
Total Current Assets		
Fixed Assets		
Furniture and fixtures		
Equipment		
Total Fixed Assets		
Total Assets		
LIABILITIES		
Current Liabilities		
Accounts payable		
Short-term notes payable		
Total Current Liabilities		
Long-term Liabilities		
Long-term notes payable		
Total long-term liabilities		
Total Liabilities		
Owner's Equity or Net Worth (Subtract Total Liabilities from Total Assets)		
Total Liabilities and Net Worth (Add Total Liabilities and Net Worth together)		

What can it tell you?

By dividing the Total Liabilities (the total debts of your business) by the Owner's Equity or Net Worth, you'll get the debt-to-equity ratio of your business. This ratio will tell you what percentage of the business you own and what percentage your lenders own. Generally speaking, you don't want the ratio to go above 1:1 (that is, you own as much of your business as your lenders do). If it goes above 2:1 (your lenders own twice as much as you do), you may find it difficult to borrow money because even the most optimistic lender can't be sure of getting the money back out of the business. Keep in mind, though, that if you have too little debt, you may not be realizing the full potential of your business — because you can use borrowed money to expand and improve your business and make it more profitable.

By dividing Current Assets by Current Liabilities, you'll find your *current ratio.* It tells you how *liquid* your business is — how quickly you can come up with cash if you need to. A 1:1 ratio means your business has a dollar in current assets to cover every dollar of current liabilities. You don't want to fall below 1:1, and you'd like to stay at 2:1 or higher. By dividing the Current Assets minus Inventory (that is, only Cash and Accounts Receivable) by the Current Liabilities, you'll come up with the *quick ratio.* The quick ratio will give you an idea of how quickly you can come up with cash without selling off your inventory. You want your quick ratio to be at least 1:1.

By dividing the Net Income or Profit (from the income statement) by the Net Worth of the business (from the balance sheet), you can find out what your *return on equity* or return on investment is. You'd like a return at least equal to what you'd get if you just sold the business, invested the cash, and collected interest or dividends. (But if you look at your return on equity and panic because it's low, remember to take into account any money you are getting from the business as salary.)

Cash Flow Projections

Revenue and expenses rarely match each other exactly. Your revenue may come in a few times a year, whereas your expenses are likely to be fairly steady on a month-by-month basis.

As a result, knowing how much money your business is going to earn is not enough. You must also know when you are actually going to receive it. Likewise, knowing how much money you'll need to operate your business is not enough. You also have to know when you'll need it. A cash flow projection charts not only how much money you can expect to receive and pay, but also when.

You use a cash flow projection when you first start your business to help you calculate how large an operating loan you need until you can establish a revenue flow that more closely matches the amount and timing of your expenses.

Cash flow projections remain useful, if not essential, even after your business is established. While some of your expenses are fixed and occur on a regular basis, you have some control over the timing of other expenses. Cash flow projections help you plan, both to put off expenses you have control over until you expect to have the income to cover them, and to borrow money to cover expenses you can't put off. Make cash flow projections for at least six months into the future, updating them every month.

If you borrow money, the lender will want to see your cash flow projections to help decide whether and when you'll be able to repay the loan.

Refer to Chapter 1 for more about cash flow, including an explanation of how to build a cash flow table.

Hiring an Accountant

So, does your business need an accountant? If you've paid the slightest attention to anything we've said in this chapter, you'll be screaming "Yes!" Although for small businesses you definitely don't have to have an accountant as a permanent member of your staff, you need to consult an accountant on an ongoing basis to

- **Help you set up your bookkeeping system** — either a manual or computerized one, and to build in internal controls to help reduce errors and to prevent and detect theft and fraud
- **Prepare various financial statements** — such as budgets, cash flow statements, income statements, and balance sheets, based on a review and analysis of financial data
- **Prepare your income tax returns** — based on a review and analysis of financial data in the context of income tax law
- **Deal with the CRA from time to time** — if you experience difficulties arising out of your income tax returns or with respect to your GST or employer remittances

In Canada, anyone can call himself or herself an accountant. What you want is a *professional* accountant. This is key. Three types of recognized professional accountants exist: chartered accountants, certified general accountants, and certified management accountants. These accountants have a

professional designation and belong to government-recognized self-regulating bodies, just as lawyers do.

Chartered accountants (CAs) are regulated by provincial institutes of chartered accountants. They must have a Bachelor of Commerce or equivalent university degree, complete 30 months of supervised employment, take a series of professional courses, and pass a number of examinations, including a nationally administered Uniform Final Exam.

Certified general accountants (CGAs) are regulated by provincial associations of general accountants. They must have a university degree, take a series of distance learning courses through the Certified General Accountants Association, complete between two and three years of supervised employment, and pass a series of examinations.

Certified management accountants (CMAs) are regulated by provincial societies of management accountants. They must have a university degree, pass a CMA entrance examination, and complete a two-year program of study while gaining practical and relevant experience by working in a financial management and/or strategic decision-making environment. Many CMAs are senior executives who are employed by businesses, but many consulting CMAs offer strategic and financial management accounting services to the public on a fee-for-service basis.

Chapter 5

When Your Business Springs a Leak

In This Chapter

- Making a plan when you can't repay a debt
- Deciding when to declare bankruptcy

When you can't avoid trouble, you have to deal with it. So this chapter is meant to help you face your problems head-on, make an objective assessment of the situation, and try to come up with a plan of action.

Exploring Your Options when You're Out of Money

So your creditors are after you. They want their money and you haven't got it at the moment. What's going to happen and what can you do? This section offers some answers. Given the credit crisis that's been happening in North American financial markets over the last few years, and the fact that it's still tough to get credit these days, it's a really important section!

Your business can't make a payment that's due

If you borrow money, you're expected to repay it. If you don't repay, the lender is liable to get a little exercised. But what the lender can do depends on the nature of the lender and the loan, as we discuss in the following sections.

A payment on a loan from a non-commercial source

You got a loan from a family member or friend to set up your business (refer to Chapter 1), but the lender doesn't feel so charitable now — maybe he

needs the cash desperately, or maybe you've ticked her off by not taking her canny business advice.

Besides giving you the cold shoulder or not inviting you over for dinner anymore, the lender can sue for return of the money. This is true whether or not a written contract exists. An *oral contract* (a contract made through conversation) is as valid as a contract in writing. It's just harder to prove the terms of an oral contract because no one wrote them down. Your lender is legally able to tell the court about the conversations you had when the loan was made (the terms of the loan agreement will be the lender's word against yours), can require other people who have heard you talk about the loan to repeat in court what they heard, and can show to the court documents such as a note or letter you wrote to the lender acknowledging the loan or saying you would pay the money back.

So don't ignore the lender or tell him to buzz off. If you have no money to pay now, try to reach some kind of agreement:

- See if the lender will agree to wait a few weeks or months until you do have the money.
- See if the lender will agree to accept smaller payments over a longer term, or smaller payments now and "balloon" payments later to make up for the smaller payments now.
- Offer something other than money in full or part payment of the loan — something you own or the business owns, or your services for free.
- Offer security for the loan, such as a mortgage on property you own, or offer a share in your business (although doing these things could create more problems for you in the long run).

Then put into writing the agreement you've reached, copy and sign it, have the lender sign it, and get it witnessed. Each of you should get an original of the two signed agreements.

A payment on a loan from a commercial source

If you have a commercial loan, you probably agreed to pay it off in instalments, so you may think not being able to pay one instalment is not such a big deal. You're wrong. Most commercial term loans (refer to Chapter 1) have an acceleration clause: The lender can demand you repay the entire loan as soon as you miss one payment by more than a few days. And if you have a line of credit (refer to Chapter 1), it's probably repayable on demand — so you don't even have to miss one payment before the lender has the right to tell you to repay the full amount.

If a lender makes a demand for repayment and you can't repay, the lender has the right to sue you for the outstanding amount of the loan, plus interest owing, plus the lender's costs of collecting the debt from you. If you've given security for the loan (a right against property — again, check out Chapter 1),

your agreement with the lender probably allows the lender to realize on the security after you miss a payment. That means the lender, after demanding repayment of the loan and waiting a few days for payment,

- Can take property you offered as security and either keep it or sell it (or start a lawsuit for possession of the secured property if you won't let the lender have it)
- Can demand that a person who guaranteed the loan pay back the loan (plus interest)
- May be able to appoint a receiver/manager to take possession of the secured property and sell it, depending on the terms of the loan agreement

If a lender seizes secured property, you may have the right for a short period (a couple of weeks) to get the property back by paying what you owe plus interest and costs. If the lender sells the property, it has to make sure it gets a fair price, and afterward has to account to you for the property. The lender is not allowed to keep more than it's owed (don't forget, this includes interest and the costs of taking and selling the property), and it has to pay you any surplus from a sale.

If you know you don't have the money to make a payment, but you think you'll have money soon to get back on track, try the following:

- First, try to find the money for the payment from another source (called *bridge financing*), if you can. Unless you're on really good terms with your commercial lender and have the lender's trust and adoration, it's probably best not to let the lender know you're in a bit of trouble. The lender might panic and pull the plug on your loan, and on any other dealings you have with that lender.
- Then, if you can't get money from another source, talk to your lender before the due date of the payment you're going to miss. Certainly talk to your lender before one of your cheques bounces. The lender may agree to overlook your default for a short time, especially if you offer some additional security (if you've got anything left that's not already being used for security, that is — if you don't, the lender might accept security from someone else, such as a personal guarantee from a relative or associate).

Be careful about borrowing more money and offering more security for a loan you're already having trouble repaying! You may just be digging yourself deeper into a hole, and in the long run you may lose more.

If you're in a really bad financial position and you don't think a little extra money or a little extra time is going to do anything but delay bigger trouble, think about making a proposal to all of your creditors or even going bankrupt (see the section "Your business is insolvent").

A payment for an asset bought on credit

If you've bought assets (such as equipment or vehicles or furniture) for your business and are paying for them over time, you've almost certainly entered into a financing agreement such as a chattel mortgage, a conditional sales agreement, a purchase money security interest, or a lease with an option to purchase. If you stop making your payments, the other party to the financing agreement can

- Sue you for the full amount still left to pay (plus interest)
- Seize the asset and sell it (and account to you after the sale)

See if the financer is willing to give you more time to pay (and then try to find some money) . . . that's about all you can do.

A payment under an equipment lease

If your business leased assets instead of buying them outright or on time, you're not in any better position if you stop making your regular payments. The terms of a commercial asset lease normally don't allow you to stop making your lease payments for any reason — and that includes the fact that the asset is broken or defective and the fact that you have no money. You have to make all the payments for the full term of the lease. If you miss a payment, the lessor can

- Sue you for the full amount owed under the lease
- Seize the asset (and, if you have an option to purchase, sell it and account to you)

Once again, about the only thing you can do is try to negotiate more time to pay, and look for some money to pay with.

You've personally guaranteed a debt for your business and your business can't pay

If you've given a personal guarantee for a business loan and your business can't make a payment, the lender can demand payment from you. If you don't pay, the lender can sue you for the full outstanding amount of the loan, plus interest. If you gave security (such as a mortgage on your home) as well as guaranteeing the debt, the lender can realize on the security.

If you've co-signed a loan with your business, the lender doesn't even have to wait for your business to miss a payment — it can demand you make the payment instead, because you're equally responsible for the loan from the get-go.

Note that if you're a member of a partnership, in most provinces the partners are individually responsible for paying debts of the partnership if the partnership itself can't pay.

Your business can't pay its rent

If you can't pay the rent owing under your commercial lease, your landlord can do a variety of nasty things to you, including

- Sue you for *arrears of rent* (rent owing) or for *damages* (money compensation) for breach of the lease, while letting you stay on under the lease.
- Retake possession of the premises and terminate the lease (in which case, although the landlord can sue for arrears of rent before termination, it can't sue for any rent due after the date of termination).
- Retake possession of the premises and terminate the lease with notice for future loss of rent. (Then the landlord can sue for arrears of rent before termination and also for damages for future loss of rent after the date of termination. If the landlord makes a reasonable effort but can't find another tenant, or another tenant who's willing to pay as much as you agreed to pay, the landlord can sue you for the entire shortfall over the rest of the term of your lease.)
- Retake possession of the premises without terminating the lease, and re-letting the premises acting as your agent (you remain responsible for the rent, minus whatever the landlord collects from the new tenant).
- *Distrain* (seize and sell) your property on the premises to satisfy arrears of rent. In most provinces, if you remove your property from the premises to keep your landlord from getting its hands on it, the landlord can seize the property wherever it is (if the landlord can find it) within the next 30 days and can make you pay a penalty for being such a sneak.

If your landlord terminates your lease, retakes possession of your premises, or distrains, consider seeing a lawyer to find out whether the landlord is within its rights. Landlords sometimes ignore the fine print of the law, and you may have some rights of your own. For example:

- A landlord cannot terminate a lease for non-payment until the rent has been unpaid for 15 days or more in most provinces (and it can't terminate for other reasons without giving you proper notice and a chance to fix whatever the landlord is complaining about).
- If the landlord terminates, you can go to court to get the termination set aside — if you can pay the arrears of rent.
- A landlord can't distrain until the day after the rent was due, and has to carry out the *distraint* (also known as a *distress*) during daylight hours.

- A landlord that distrains (in most provinces) can't seize fixtures, cash, property that belongs to others (such as inventory on consignment), or perishable goods, and it has to leave tools you use in the business up to a value of $2,000.
- The landlord has no right to distrain if it has already got a judgment for arrears of rent, or has terminated the lease or locked you out, or if you and the landlord have agreed the lease is at an end.

Your business can't pay a mortgage on real property

If you took out a mortgage to buy real property for your business and you can't make your payments, the mortgagee (the lender) has the right in many provinces to foreclose on the mortgage (become the legal owner of the property) or to sell the property — under court supervision in a judicial sale, or privately under a power of sale.

If the mortgagee starts a legal action for foreclosure or judicial sale, you can stop it by paying off the entire mortgage, or in some cases by paying the payment(s) you missed plus a penalty. If you can't pay the entire mortgage immediately, you can ask the court for a delay (from about two to six months) in order to come up with the money. You can also stop foreclosure by asking for judicial sale. If the foreclosure goes through, in most provinces your mortgage debt is cancelled and you don't owe the mortgagee anything, even if the property is worth less than the debt you owe (but on the other hand the mortgagee doesn't owe you anything if the property is worth more than the debt you owe). If the property is sold in a judicial sale, any money left over after payment of the mortgage debt plus interest plus legal costs is yours; but if a shortfall occurs, the lender can require you to make it up.

Most mortgagees prefer to act under a power of sale, if they can, because they don't have to go to court to sell the property. The lender has to notify you it's going to exercise its power of sale, and you'll be given a short time (about a month) to stop the sale by paying off the mortgage or in some cases by making up the payment(s) you missed. As with a judicial sale, the proceeds from the sale will be used to pay the outstanding amount of the mortgage, as well as interest and costs; the mortgagee can sue you for any shortfall, but if money is left over the mortgagee has to return it to you.

If the mortgagee wants to sell the property, see if it will let you try to sell the property yourself first. Buyers may think they can get a good deal and may offer a lower price when they see it's a judicial sale or sale under a power of sale. The more money the property sells for, the less you'll owe the mortgagee or the more you'll get to keep.

Your business can't pay its taxes

The Canada Revenue Agency (CRA) has a *statutory lien* against the personal property (as opposed to real property, or real estate) of a taxpayer who does not pay taxes or remittances that are due. This lien lets the government seize your business's personal property — which is your personal property, if you're a sole proprietor or partner — after giving 30 days' notice (during the notice period you can pay up and avoid the seizure).

If you own real property in a municipality and you don't pay your property taxes, the municipality will add interest charges and penalties to your property tax bill. If you still don't pay your taxes, the municipality has the right to sell your real property. (The municipality doesn't get to keep all the money from the sale, only the amount you owe in taxes.)

Your business is insolvent

Your business is insolvent if it owes at least $1,000 and cannot pay its debts as they become due. Nothing is wrong with being insolvent in itself (apart from the fact that you have no money), but if you're insolvent you're in danger of being forced into bankruptcy. A creditor to whom you owe more than $1,000 and who has no security from you for the debt can petition your business into bankruptcy if your business commits an act of bankruptcy — such as not paying a debt when it's due, not complying with a court order to pay a creditor who's won a lawsuit against the business, telling a creditor you're not going to pay your debts, or hiding or disposing of property to avoid paying a creditor.

If you're dealing with unsecured creditors

If you're insolvent, what can you do before someone petitions you into bankruptcy? You can try to reach some kind of agreement with your creditors — for example, that they'll give you more time to pay, or accept partial payment of your debt. Put any agreement into writing. By the way, your creditors won't likely be interested in cutting you some slack unless your business has decent prospects. Bankers aren't paid to be nice.

If your business does have prospects, it might be wise to get some advice from a lawyer who specializes in insolvency, or from a *trustee in bankruptcy* who deals with businesses (rather than with consumers). Your adviser might recommend making an informal offer to your creditors, or a formal proposal under the *Bankruptcy and Insolvency Act*.

If you're dealing with secured creditors

If you're insolvent and a secured creditor notifies you that it's going to realize on its security, consider making a formal proposal under the *Bankruptcy and Insolvency Act.* If you do nothing at this point, your secured creditors are going to make off with the secured property, and you probably need it to keep your business running. Get a trustee in bankruptcy to advise you and to file in bankruptcy court a notice of intention to make a proposal. After the notice is filed, your business has some protection from secured and unsecured creditors for at least a month:

- Creditors can't seize any property.
- Companies that supply things such as electricity, heat, water, and telephone can't cut off service.
- Parties to contracts with your business can't terminate the contracts or invoke acceleration clauses (an acceleration clause makes a debt you're paying off in instalments come due all at once).

On the downside, you have to pay cash upfront for any supplies you buy.

After you file your notice of intention, you have to file the actual proposal, and then your creditors meet within about three weeks to vote on it. Here's another downside to the proposal process: If your secured creditors reject the proposal (even if your unsecured creditors don't), they can immediately realize on their security. In addition (as if you needed an addition at this point), your business is deemed to have made an *assignment in bankruptcy* (a transfer of its property to the trustee in bankruptcy) and will be officially declared bankrupt.

Declaring Bankruptcy

You can be forced into bankruptcy, but you can also choose to go into bankruptcy by making an assignment in bankruptcy. Why would you actually want to go bankrupt? Well, after you're declared bankrupt by a court, your trustee in bankruptcy deals with your creditors. You don't have to look at their ugly faces anymore. (Rest assured — the faces of bankers who circle your financial wagon are very ugly!) Your trustee will make arrangements to sell the business's property to pay the debts. And you may be able to start over again.

If you're carrying on business as a sole proprietorship or a partnership, you'll go bankrupt as an individual. If you're carrying on business as a corporation, the corporation will go bankrupt. As an individual you'll probably be discharged from bankruptcy after nine months, and if you receive an absolute discharge,

almost all of your debts are cancelled. (If you receive a conditional discharge, you'll still be responsible for repaying certain debts — income taxes, for example.) A corporation can't be discharged until it has paid all its debts, but you can always start up a new corporation (however, you may find that the creditors you stiffed won't be very eager to deal with your new corporation).

After the bankruptcy court has made an order that your business is bankrupt, it appoints a trustee in bankruptcy. The trustee becomes the legal owner of all the unsecured property that formerly belonged to your business (and to you if your business is a sole proprietorship or a partnership — see Chapter 2) and it uses the property to pay off debts. Your secured creditors keep their rights over secured property. It doesn't go to the trustee.

If you're a sole proprietor or partner and you go bankrupt, you'll be allowed to keep some personal property — about $5,000 worth (more in some provinces) of clothing, furniture, and "tools of your trade."

If your business is a corporation and you're a director, you may not escape having to make some payments personally if your business goes bankrupt. You'll be held responsible for up to six months' worth of unpaid wages for employees, for unpaid amounts owed to the CRA for income tax and GST/HST, Canada Pension Plan, and Employment Insurance, and for unpaid provincial sales tax owed to your provincial department or ministry of finance. And that's on top of paying any business loans for which you gave a personal guarantee.

If your business disposed of any property to save it from creditors, you can be personally charged with a criminal offence. And your trustee in bankruptcy can sue to get his hands on property that was improperly transferred away from the business, so that it can be distributed among the creditors.

If a person or business is an undischarged bankrupt, he, she, or it can't borrow more than $500 without telling the lender about the state of bankruptcy (and not telling is an offence punishable by a fine or imprisonment). If a person is an undischarged bankrupt, he or she cannot be the director of a corporation.

Appendix A

Your Personal RRSP Planner

Banks are pleased to help you plan for your retirement in various ways, such as providing methods of calculating the assets needed to meet your anticipated income. This generic version of a widely used formula assumes a 3-percent annual inflation rate and an 8-percent annual return on your investments over a 20-year retirement period. Those are fairly conservative measurements, but hey, we Canadians have always been a little cautious when it comes to planning for the future.

Step 1: How much annual income will you need? (Assume 70 percent of your current income): $_____

Step 2: From Column A in Table A-1, find the number of years until you plan to retire, choose the corresponding **Growth Factor for Income** from Column B, and write it here: _____

Step 3: Multiply Step 1 by Step 2: _____

Step 4: What is the current value of your RRSP? _____

Step 5: From Column C in Table A-1, choose the **Growth Factor for Investments** that matches the number of years until you retire and write it here: _____

Step 6: Multiply Step 4 by Step 5 and write it here: _____

Step 7: Subtract Step 6 from Step 3 and write it here: _____

The last figure you calculate is the amount you'll need to contribute each year until you retire.

Table A-1 Growth Factors

A	*B*	*C*
Years to Retirement	*Growth Factor for Income*	*Growth Factor for Investments*
35	0.1440	0.0572
30	0.1947	0.0610
25	0.2697	0.0667
20	0.3875	0.0756
15	1.5912	0.0910
10	1.0100	0.1226
5	2.2901	0.2194

Once you're done, you'll likely realize that putting away the amount in Step 7 on a yearly basis isn't going to be the monolithic task you at first thought. When you follow the process back to the somewhat intimidating amount in Step 1, you can nevertheless breathe a little easier as you realize, "Yes, I can do this."

Appendix B

Prepare to Meet Your Lawyer

To plan your estate properly and carry out the plan, you need a lawyer. While you're in the planning stages, your lawyer will be able to help you prepare a complete estate plan that answers all your needs by taking you through the foreseeable possibilities about your future and your family's future. When you're ready to put your plan into action, your lawyer can draft your will and other legal documents, such as a power of attorney and a living will, that reflect your wishes.

Use the form in this appendix to make sure your lawyer has all the information necessary to do the best job possible for you.

INFORMATION ABOUT YOU

Have you ever made a

- ☐ Will?
- ☐ Power of attorney?
- ☐ Living will?

If so, bring the documents to your meeting with your lawyer.

INFORMATION ABOUT YOUR FAMILY

Marital Status

Are you currently

- ☐ Single? If you are living with someone, bring any cohabitation agreement you have signed.
- ☐ Planning to marry? If so, bring any marriage contract you have signed or are thinking of signing.
- ☐ Married? If so, bring any marriage contract you have signed.
- ☐ Separated? If so, bring any separation agreement you have signed or are thinking of signing, and any court orders that have been made.
- ☐ Divorced? If so, bring your divorce decree and any separation agreement and court orders.
- ☐ Widowed? If so, bring a copy of your spouse's will.

Your Children

	Child #1	Child #2	Child #3	Child #4
Name	_____	_____	_____	_____
Date of birth	_____	_____	_____	_____
In your custody or another's	_____	_____	_____	_____
Disabilities or special needs	_____	_____	_____	_____

Bring any documents, such as a separation agreement or court order, that affect your relationship with your children.

Who would you like to look after your underage children if both parents are dead?

_____

Your Grandchildren

	Grandchild #1	Grandchild #2	Grandchild #3	Grandchild #4
Name	_____	_____	_____	_____
Date of birth	_____	_____	_____	_____
Disabilities or special needs	_____	_____	_____	_____

Other Family Members or Friends (for whom you have a moral obligation to support financially)

	Person #1	Person #2	Person #3
Name			
Date of birth			
Disabilities or special needs			

Pets to Be Cared For

	Pet #1	Pet #2	Pet #3	Pet #4
Name				
Type of pet				
Date of birth				
Special needs				

INFORMATION ABOUT YOUR PROPERTY

Real Estate

	Property #1	Property #2	Property #3
Address			
How is it owned (by you alone, by you and another)?			
Approximate value			

Vehicles

	Vehicle #1	Vehicle #2	Vehicle #3
Description			
How is it owned (by you alone, by you and another)?			
Approximate value			

Bank/Credit Union Accounts

	Account #1	Account #2	Account #3
Location			

How is it owned (by you alone, by you and another)? _____ _____ _____

Approximate balance _____ _____ _____

RRSPs and RRIFs; RESPs and DPSPs

	Plan/Fund #1	Plan/Fund #2	Plan/Fund #3
Location			
Beneficiary named			
Approximate value			

Pension Plans

	Plan #1	Plan #2	Plan #3
Employer			
Beneficiary named			
Approximate value			

Investments (bonds, GICs, shares, mutual funds, and so on)

	Investment #1	Investment #2	Investment #3
Location			
How is it owned (by you alone, by you and another)?			
Approximate value			

Life Insurance

	Policy #1	Policy #2	Policy #3
Insurance company			
Beneficiary named			
Face amount of policy			

Valuable Personal Possessions (electronic equipment, art, antiques and heirlooms, jewellery, silverware, furs)

	Possession #1	Possession #2	Possession #3	Possession #4
Description				
Location				
How is it owned (by you alone, by you and another)?				
Approximate value				

Furniture and Household Contents

How are they owned (by you alone, by you and another)? _____

Approximate value _____

Money Owed to You

	Amount #1	Amount #2	Amount #3
Owed by			
Owed because of			
Due on			
Approximate amount			
Supporting documents (mortgage, contract, court order, and so on)			

Your Business

Description _____

Address(es) _____

_____

_____

How is it owned (sole proprietorship, partnership, corporation) and what is your share?

_____

Approximate value (of assets less liabilities if sole proprietorship or partnership, of shares if corporation)

_____

INFORMATION ABOUT YOUR DEBTS

Mortgages

	Mortgage #1	Mortgage #2	Mortgage #3
Address of property			
Name and address of mortgagee			
Approximate outstanding balance			

Loans

	Loan #1	Loan #2	Loan #3
Description (car, line of credit, and so on)			
Name and address of lender			
Approximate outstanding balance			

Outstanding Taxes and Penalties

CRA _____

Property taxes _____

Condominium Assessments _____

Other _____

Family Law Support Orders

	Family Member #1	Family Member #2	Family Member #3
Amount of payment			
Frequency of payment			
Probable end date			

Court Judgments against You

Amount of judgment _____

Date of judgment _____

Have you ever declared bankruptcy? _____ If so, bring those documents to your lawyer.

OTHER ADVISERS

Lawyer

Name _____ Address _____

Kind of work done for you _____

Accountant

Name _____ Address _____

Kind of work done for you _____

Bank/Credit Union Manager

Name _____ Address of bank branch _____

Kind of work done for you _____

Insurance Broker

Name _____ Address _____

Kind of work done for you _____

Investment Adviser/Financial Planner

Name _____ Address _____

Kind of work done for you _____

Other

Name _____ Address _____

Kind of work done for you _____

LIFE INSURANCE AND PENSIONS

Life Insurance

	Policy #1	Policy #2	Policy #3
Description			
Beneficiary			

Pension Plans

	Plan #1	Plan #2	Plan #3
Description			
Beneficiary			

YOUR WISHES FOR YOUR WILL

Your first choice(s) for executor(s) _____

Alternate choice(s) for executor(s) _____

Specific Gifts

Personal Effects

	Item #1	Item #2	Item #3	Item #4
Description				
Beneficiary				

Real Estate

	Property #1	Property #2	Property #3	Property #4
Description				
Beneficiary				

Vehicles

	Vehicle #1	Vehicle #2	Vehicle #3
Description			
Beneficiary			

RRSPs and RRIFs

	Plan/Fund #1	Plan/Fund #2	Plan/Fund #3	Plan/Fund #4
Description				
Beneficiary				

Investments

	Investment #1	Investment #2	Investment #3	Investment #4
Description				
Beneficiary				

Cash

	Amount #1	Amount #2	Amount #3	Amount #4
Amount				
Beneficiary				

Pets

	Pet #1	Pet #2	Pet #3	Pet #4
Name of pet				
Beneficiary				

Family Business

Description _____

Beneficiary _____

Other

Description _____

Beneficiary _____

Residue

(What's left over after you have made all your specific gifts)

If you have a spouse: Would you like all the residue to go to your spouse, would you like none of the residue to go to your spouse, or would you like some of the residue to go to your spouse and some to others? _____

_____

If you have children:

How would you like to divide your estate among them? _____

_____

What should happen to one child's share if that child dies before you? _____

_____

If your children are young, until what age should their shares be held in trust? _____

How should a child's trust fund be used (for example, not used until child comes of age, used for child's education, paid out to child as a regular allowance, and so on)?

_____

If you have grandchildren:

How do you want them to share in your estate? _____

What should happen to one child's share if that child dies before you? _____

_____

If your grandchildren are young, until what age should their shares be held in trust? _____

How should the grandchildren's trust fund be used (not used until child comes of age, used for child's education, paid out to child as a regular allowance, and so on)?

_____

If you have no immediate family:

Would you like to give friends or other relatives a share of your estate? _____

Names of friends or relatives _____

_____

What should happen to someone's share if he or she dies before you? _____

_____

Would you like to give something to charity? _____

Name of charity or charities _____

Approximate amount you would like to give _____

Is there anyone you wish to exclude from your will who might expect to be mentioned in your will?

_____

YOUR WISHES FOR YOUR POWER OF ATTORNEY

Your first choice(s) for your attorney(s) _____

Your alternate choice(s) for your attorney(s) _____

When would you like the power of attorney to come into effect — immediately, or when you become physically disabled, suffer from minor mental disability, or suffer from major mental disability?

_____

Do you want the power of attorney to give your attorney(s) all the powers you have to deal with your affairs, or would you like to limit the attorney(s)'s powers?

_____

YOUR WISHES FOR YOUR LIVING WILL

Your first choice(s) for your substitute decision maker(s): _____

Your alternate choice(s) for your substitute decision maker(s): _____

What are your wishes about prolonging your life or hastening your death? _____

_____

_____

Appendix C

Instructions for Your Executor

Your executor has a lot to do when you kick the bucket, including collecting your important documents, making your funeral arrangements, and generally making sure your wishes for your estate are followed in letter and in spirit. You can find more about the duties of an executor at great length in Chapter 3 in Book VII.

Use the form in this appendix to make sure your executor can get a running start on the job.

INSTRUCTIONS TO MY EXECUTOR

My will:

The lawyer/notary who drafted my will is: _____

You will find the original of my will in the following place: _____

_____

The following are my wishes for organ and tissue donation:

- ☐ I wish to donate the following: _____

  _____
- ☐ My consent to donation documents can be found in: _____
- ☐ I have notified the following registry that I would like to donate: _____
- ☐ I wish to donate my body.
- ☐ I have contacted the following institution to pre-arrange body donation:

  _____
- ☐ I have not contacted any institution but would like to donate my body to:

  _____
- ☐ I do not wish any of my organs or tissues to be donated.
- ☐ I do not wish to donate my body.

The following are my wishes for my funeral:

If pre-arrangements have been made:

I have pre-arranged my funeral at the following funeral home: _____

- ☐ I have prepaid my funeral.
- ☐ I have not prepaid my funeral.

My funeral has been pre-arranged but not prepaid and I would like it to be paid out of the following bank account(s) or insurance policy or benefit plan:

_____

_____

My documents relating to pre-arrangement or prepayment can be found in:

_____

_____

I own a plot at the following cemetery: _____

☐ I own the plot alone.

☐ I own the plot with the following person:

My documents relating to the plot can be found in: _____

If no pre-arrangements have been made:

☐ I would like to use the following funeral home: _____

☐ I leave it to you to choose a funeral home.

I would like my body to be treated in the following way:

☐ Embalmed ☐ Not embalmed

☐ Made up ☐ Not made up

I would like to be buried in the following clothes: _____

_____

If possible, I would like to have the following item(s) buried with me: _____

_____

I would like my obituary to appear in the following papers: _____

_____

☐ I have written my obituary. You will find it in: _____

_____

☐ I would like the following person or people to write my obituary: _____

_____

☐ I do not want a visitation.

☐ I would like a visitation.

☐ For the visitation, I would like my coffin to be open.

☐ I do not want an open coffin.

☐ I would like a funeral service. OR ☐ I would like a memorial service.

If necessary, I would like my funeral service delayed a reasonable length of time to permit the following people to attend:

_____

_____

I would like the following person to officiate at my service: _____

If he or she is not available, then my second choice is: _____

I would like the funeral service to be held at: _____

_____

I would like the following kind of service: _____

I would like the following passage(s) to be read at the service: _____

_____

_____

_____

I would like the following music played at the service: _____

_____

I would like the following person or group to play the music at the service: _____

_____

I would like the following hymns sung at the service: _____

_____

_____

I would like the following prayer(s) to be said at the service: _____

_____

_____

☐ I don't want anyone to deliver a eulogy.

☐ I would like the following person or people to deliver a eulogy: _____

_____

I would like the following people to be pallbearers at a funeral service: _____

_____

_____

I would like the following people to be ushers at a funeral or memorial service: _____

_____

_____

I would like a reception following the funeral, to be held at: _____

_____

☐ I would like memorial donations instead of flowers.

☐ I would like mourners to be given the choice between memorial donations and flowers.

Disposal arrangements if no pre-arrangements have been made:

☐ I would like to be buried.

☐ I would like to be buried in the following cemetery: _____

_____

☐ I leave it to you to choose a cemetery.

☐ I would like a monument:

☐ An upright stone

☐ A marker

Description of the stone or marker I would like: _____

_____

I would like the following engraved on my monument: _____

_____

_____

☐ I would like to be cremated:

☐ I would like my ashes to be scattered at: _____

_____

☐ I would like my ashes to be buried at: _____

_____

☐ I would like my ashes to be put in a columbarium at: _____

_____

If my ashes are buried or put in a columbarium, I would like the following engraved on my monument:

_____

_____

☐ I realize it is difficult to do, but I would like to be buried at sea if possible:

My preferred location is: _____

_____

☐ Other instructions for disposal of my remains:

_____

_____

☐ I would like a memorial tree planted for me at: _____

_____

☐ If possible, I would like a memorial plaque put up for me at: _____

_____

I would like the following engraved on the memorial plaque: _____

_____

_____

Other instructions for a memorial: _____

_____

_____

Payment

I would like the cost of my funeral and disposal to be paid out of the following bank account(s), insurance policy, or benefit plan:

_____

_____

_____

_____

Appendix D

Inventory for Your Executor

When you die, your executor will arrive on the scene and immediately need lots and lots of pieces of paper. Not making sure your executor will have what she needs will really make her regret your death.

Use the form in this appendix to prepare an inventory of your important documents and where your executor can find them.

INVENTORY FOR MY EXECUTOR

Inventory made as of: ___/___/
DAY/MONTH/YEAR

The original of my will is located in: _____

_____

The name and address of my lawyer/notary: _____

_____

The name and address of my financial adviser or accountant: _____

_____

The name and address of my insurance agent: _____

_____

I have a safety-deposit box at the following bank or trust company:

Name and address of bank	Location of key

My important documents (for example, investment certificates, bonds, share certificates, ownership documents, loan documents, valuations of property, passport, and so on) include the following:

Document	Location

I have money in the following bank accounts:

Address of bank	Account number	If joint account, joint owner is

I own the following RRSPs or RRIFs:

Name of institution	Description

I am a member of an employee pension plan at the following institutions:

Institution name and address	Plan name or number

I own the following life insurance policies:

Name of insurance company	Face amount of policy	Named beneficiary

I have investment portfolios with the following advisers: _____

For stocks owned jointly, the joint owner is: _____

I own or rent the following real estate:

Address	If jointly owned, joint owner is	If mortgaged, mortgagee is

I own or lease the following vehicles:

Description of vehicle	Location	If jointly owned, joint owner is

I own personal property that is kept outside my residence(s):

Description	Location

The following property is being held by me but belongs to someone else:

Description of property	Name and address of owner

I am owed money by the following people or organizations:

Name of debtor	Description of credit	Amount owed

I owe money to the following:

Name of creditor	Description of debt	Amount owed

WARNING! I have concealed valuable property in the following places (so be careful about throwing anything out!)

Appendix E

Sample Business Plan

Here is a simple business plan for your review. The elements of this plan will help you understand how important this document is for every small business. They may seem like a lot of work to create — but business plans are an essential blueprint for where you want your business to go!

The sample business plan is reprinted courtesy of Palo Alto Software, www.paloalto.com, 1-800-229-7526.

January 2001

This sample business plan has been made available to users of*Business Plan Pro*™, business planning software published by Palo Alto Software. Names, locations and numbers may have been changed, and substantial portions of text may have been omitted from the original plan to preserve confidentiality and proprietary information.
You are welcome to use this plan as a starting point to create your own, but you do not have permission to reproduce, publish, distribute or even copy this plan as it exists here.
Requests for reprints, academic use, and other dissemination of this sample plan should be emailed to the marketing department of Palo Alto Software at marketing@paloalto.com. For product information visit our Website: www.paloalto.com or call: 1-800-229-7526.
Copyright Palo Alto Software, Inc., 1995-2002

Confidentiality Agreement

The undersigned reader acknowledges that the information provided by _____ in this business plan is confidential; therefore, reader agrees not to disclose it without the express written permission of _____.

It is acknowledged by reader that information to be furnished in this business plan is in all respects confidential in nature, other than information which is in the public domain through other means and that any disclosure or use of same by reader, may cause serious harm or damage to _____.

Upon request, this document is to be immediately returned to _____.

_____ Signature

_____ Name (typed or printed)

_____ Date

This is a business plan. It does not imply an offering of securities.

Table of Contents

1.0 Executive Summary 1
1.1 Mission 2
1.2 Keys To Success 2

2.0 Company Summary 3
2.1 Company Ownership 3

3.0 Start-Up Summary 3

4.0 Service Description 4

5.0 Market Analysis 4
5.1 Market Segmentation 5
5.2 Target Market Segment Strategy 5
5.3 Market Needs 5
5.4 Service Business Analysis 6

6.0 Strategy and Implementation 6
6.1 Competitive Edge 6
6.2 Sales Strategy 6

7.0 Management Team 8
7.1 Personnel Plan 8

8.0 Financial Plan 9
8.1 Break-even Analysis 9
8.2 Projected Profit and Loss 10
8.3 Projected Cash Flow 11
8.4 Projected Balance Sheet 12

Appendix 14

Business Solutions Consulting

1.0 Executive Summary

Business Solutions Consulting (BSC) is a start-up consulting firm focused on serving the comprehensive needs of businesses in the full range of the business cycle.With a core staff of experienced professionals and a team approach to most consulting projects, BSC will be able to offer a more balanced quality service than many of its competitors.

BSC offers a list of services for business owners to choose from, depending on their particular business needs. This includes; business and marketing plan preparation, financial search and procurement, IT consulting services, management development, human resources advising, and etc.

BSC will have a focus on start-up businesses, preferably in the earlier stages of operation. Small and mid-sized businesses make up a sizable majority of U.S. and international markets. BSC prefers to establish a relationship with a younger operation and continue to nurture that relationship over the long term.

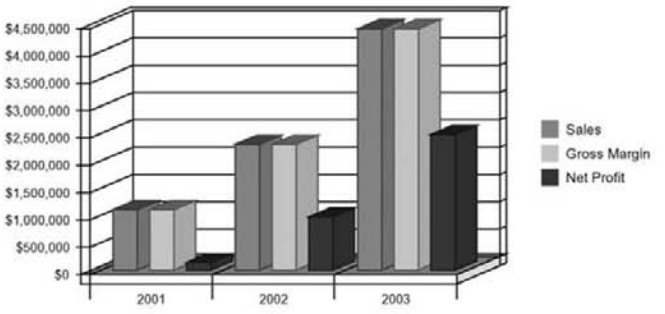
Competitors in the forefront of the marketplace typically offer many of the same services as BCS. These services include information-based consulting, integration and management services. Services are designed to increase clients' operations effectiveness through reduced cost, improved customer service, enhanced quality of current product lines and services, and a more rapid introduction of new products and services. Competitors also offer industry-specific expertise to objectively evaluate, select, develop, implement, and manage information systems, networks, and applications.

BSC's co-owners, Andrew B. Christiansen and David E. Fields, will each provide $50,000 that will cover the bulk of the start-up expenses. The rest of the required financing will come from the Small Business Administration (SBA) 10-year loan in the amount of $100,000. Combined, these funds will be sufficient to cover the company's expenses throughout the first year of operations, which is the most critical from the cash flow standpoint.

BSC's Break-even Analysis is based on the average of the first-year figures for total sales by salaries, bonuses costs, and all other operating expenses. Such analysis shows that BSC will break-even by the tenth month of operations.

Business Solutions Consulting

Highlights



1.1 Mission

Business Solutions Consulting aims to offer comprehensive consulting services. BSC will focus on providing personal and specialized services to meet each client's specific needs.

1.2 Keys To Success

BSC's keys to success include:

1. A group of professionals with a broad range of specialty areas that complement each other.
2. A high level of experience in these specialty areas.
3. A team approach on most consulting projects.
4. Many business contacts among the consultant group.

2.0 Company Summary

Business Solutions Consulting is a startup firm, which will focus on providing a wide range of business consulting services to other startups and companies in early stages of their operations. Business Solutions Consulting is a team of six Business Consultants. Each consultant specializes in a particular discipline, including finance, sales and marketing, technology, management, operations, and human resources.

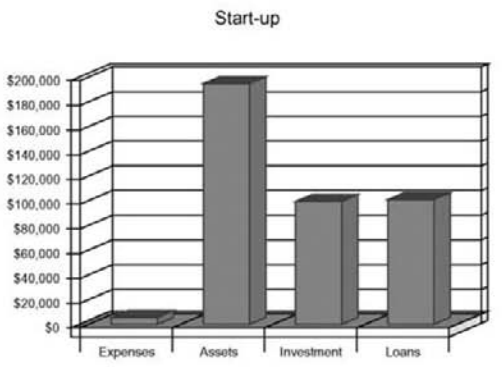
2.1 Company Ownership

Business Solutions Consulting was registered in September, 2000 as an Oregon LLC, equally owned by Andrew B. Christiansen and David E. Fields.

3.0 Start-Up Summary

BSC's co-owners, Andrew B. Christiansen and David E. Fields, will each provide $50,000 that will cover the bulk of the start-up expenses. The rest of the required financing will come from the Small Business Administration (SBA) 10-year loan in the amount of $100,000. Combined, these funds will be sufficient to cover the company's expenses throughout the first year of operations, which is the most critical from the cash flow standpoint.

The following chart and table contain projected initial start-up cost data.



Business Solutions Consulting

4.0 Service Description

BSC offers a list of services for business owners to choose from, depending on their particular business needs.
Start-up services include business plan preparation, marketing plan preparation, and financing search and procurement. Ongoing services include business plan updates, marketing plan updates, search and procurement of additional rounds of financing, management development, IT consulting services, e-commerce consulting services, operational advising, and human resources advising.
BSC is flexible, working with its clients in the fashion preferred by the client, be it on-site, remotely, or a combination of both. BSC typically works on a project in a team fashion to assist the client in all areas of the business simultaneously. This allows for all parties involved to be in sync in terms of understanding the interconnections of all functional areas of the business.

5.0 Market Analysis

BSC will have a focus on start-up businesses, preferably in the earlier stages of operation. Small and mid-sized businesses make up a sizable majority of U.S. and international markets. BSC prefers to establish a relationship with a younger operation and continue to nurture that relationship for the long term. The following chart and table show BSC's projected target markets and their growth for the first three years of this plan.

Market Analysis (Pie)

Table: Market Analysis

Market Analysis							
Potential Customers	Growth	2001	2002	2003	2004	2005	CAGR
Start-Up Companies	10%	1,900,000	2,090,000	2,299,000	2,528,900	2,781,790	10.00%
1-3 Year Old Companies	8%	900,000	972,000	1,049,760	1,133,741	1,224,440	8.00%
3 + Year Old Companies	6%	400,000	424,000	449,440	476,406	504,990	6.00%
Other	0%	0	0	0	0	0	0.00%
Total	8.96%	3,200,000	3,486,000	3,798,200	4,139,047	4,511,220	8.96%

5.1 Market Segmentation

Start-Ups

Start-up companies often are in need of expert advice and planning in initiating a successful start-up. It is believed that a majority of start-ups actually seek out consulting assistance. Those that do typically are searching for a comprehensive area of services.

1-3 Year Old Companies

Young companies, between 1 and 3 years old are less likely to be searching for expert business consulting services. Typically, they have already secured financing and have developed a satisfactory level of security. However, these businesses are still in the beginnings of their overall cycle and in most cases need the broad expertise of a team of expert consultants.

3 + Year-Old Companies

Established companies make up the final segment, and is significantly smaller than the start-up segment. The established company segment typically has a need for a less comprehensive range of services. These entities are in need of specialized services in one or two disciplines, e.g., operational planning or human resources.

5.2 Target Market Segment Strategy

Start-up companies are the target market of this firm. BSC intends to stay on the pulse of new business activity within the local area. Additionally, business contacts, referrals from among the group, and Internet marketing efforts will be made in pursuit of new clients.

5.3 Market Needs

Start-up company owners often lack the broad range of knowledge and expertise required to launch a new business. There is a serious need in the marketplace, and certainly a significant demand for, these types of start-up consulting services.

5.4 Service Business Analysis

The business consulting industry is very fragmented. Several large multi-national companies dominate the industry while many smaller (and often more specialized) firms occupy their market niches. Major management consulting companies, such as McKinsey, Bain, and Boston Consulting Group, have established their dominant position by providing services to the leading companies in various industries. Consulting practices of the major accounting firms (a.k.a. the Big Five) have established worldwide presence and sell their packaged services to companies of different sizes and industries. At the same time, numerous firms and individual business consultants prosper in the market niches that bigger players consider unprofitable to enter.

6.0 Strategy and Implementation

BSC intends to succeed by offering companies a comprehensive range of multi-cycle business planning solutions.

6.1 Competitive Edge

Our competitive edge is the team approach of consultants who are each focused in one or two business disciplines.

6.2 Sales Strategy

BSC intends to succeed by offering companies a comprehensive range of multi-cycle business planning solutions. The company will strive to optimize its billing hours. The following table outlines the sales forecast for the next three years.

Business Solutions Consulting

Sales by Year

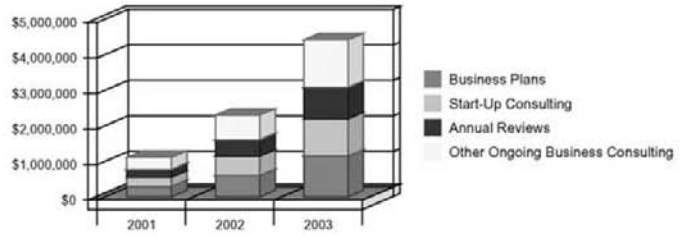


Table: Sales Forecast

Sales Forecast			
Unit Sales	2001	2002	2003
Business Plans	191	397	763
Start-Up Consulting	175	364	699
Annual Reviews	223	464	890
Other Ongoing Business Consulting	223	464	890
Total Unit Sales	812	1,688	3,242
Unit Prices	2001	2002	2003
Business Plans	$1,500.00	$1,500.00	$1,500.00
Start-Up Consulting	$1,500.00	$1,500.00	$1,500.00
Annual Reviews	$1,000.00	$1,000.00	$1,000.00
Other Ongoing Business Consulting	$1,500.00	$1,500.00	$1,500.00
Sales			
Business Plans	$286,508	$595,937	$1,144,199
Start-Up Consulting	$262,633	$546,276	$1,048,850
Annual Reviews	$222,840	$463,507	$889,933
Other Ongoing Business Consulting	$334,260	$695,260	$1,334,899
Total Sales	$1,106,240	$2,300,980	$4,417,881
Direct Unit Costs	2001	2002	2003
Business Plans	$0.00	$0.00	$0.00
Start-Up Consulting	$0.00	$0.00	$0.00
Annual Reviews	$0.00	$0.00	$0.00
Other Ongoing Business Consulting	$0.00	$0.00	$0.00
Direct Cost of Sales	2001	2002	2003
Business Plans	$0	$0	$0
Start-Up Consulting	$0	$0	$0
Annual Reviews	$0	$0	$0
Other Ongoing Business Consulting	$0	$0	$0
Subtotal Direct Cost of Sales	$0	$0	$0

7.0 Management Team

Andrew B. Christiansen has extensive experience in business planning and finance, including CFO positions with ABC Conglomerate and DEF International. David E. Fields brings in experience in the area of marketing, advertising, and communications.

7.1 Personnel Plan

The following table illustrates the personnel plan for the next three years. No major changes in headcount are planned.

Table: Personnel

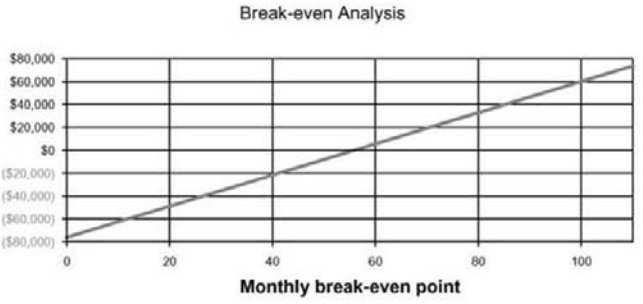
Personnel Plan			
	2001	2002	2003
Owner / Consultants	$600,000	$660,000	$726,000
Other	$0	$0	$0
Total People	6	7	8
Total Payroll	$600,000	$660,000	$726,000

8.0 Financial Plan

BSC expects to raise $100,000 as its own capital, and to borrow $100,000 guaranteed by the SBA as a 10-year loan. This provides the bulk of the current financing required.

8.1 Break-even Analysis

BSC's Break-even Analysis is based on the average of the first-year figures for total sales by salaries, bonuses costs, and all other operating expenses. These are presented as per-unit revenue, per-unit cost, and fixed costs. These conservative assumptions make for a more accurate estimate of real risk. Such analysis shows that BSC will break-even by the tenth month of operations.



Break-even point = where line intersects with 0

Table: Break-even Analysis

Break-even Analysis:	
Monthly Units Break-even	56
Monthly Revenue Break-even	$76,150
Assumptions:	
Average Per-Unit Revenue	$1,362.36
Average Per-Unit Variable Cost	$0.00
Estimated Monthly Fixed Cost	$76,150

Business Solutions Consulting

8.2 Projected Profit and Loss

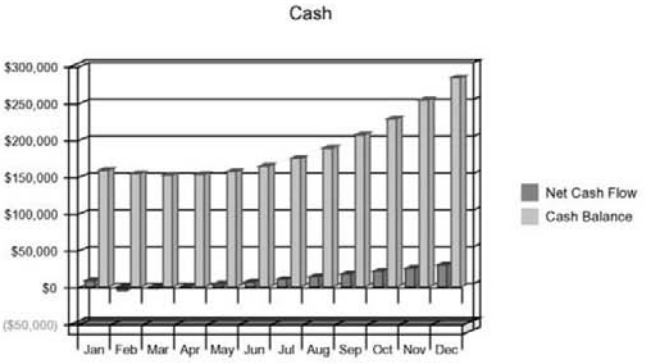
As the profit and loss table shows, BSC expects to continue its steady growth in profitability over the next three years of operations.

Table: Profit and Loss

Pro Forma Profit and Loss			
	2001	2002	2003
Sales	$1,106,240	$2,300,980	$4,417,881
Direct Cost of Sales	$0	$0	$0
Other	$0	$0	$0
Total Cost of Sales	$0	$0	$0
Gross Margin	$1,106,240	$2,300,980	$4,417,881
Gross Margin %	100.00%	100.00%	100.00%
Expenses:			
Payroll	$600,000	$660,000	$726,000
Sales and Marketing and Other Expenses	$216,600	$227,430	$238,802
Depreciation	$6,000	$6,300	$6,615
Utilities	$1,200	$1,266	$1,336
Payroll Taxes	$90,000	$99,000	$108,900
Other	$0	$0	$0
Total Operating Expenses	$913,800	$993,996	$1,081,652
Profit Before Interest and Taxes	$192,440	$1,306,984	$3,336,229
Interest Expense	$10,000	$9,661	$8,948
Taxes Incurred	$45,236	$324,331	$845,684
Net Profit	$137,204	$972,992	$2,481,597
Net Profit/Sales	12.40%	42.29%	56.17%

8.3 Projected Cash Flow

As the cash flow statement illustrates, BSC expects to maintain a steady rate of cash flow over the next three years of operations.



Business Solutions Consulting

Table: Cash Flow

Pro Forma Cash Flow	2001	2002	2003
Cash Received			
Cash from Operations:			
Cash Sales	$1,106,240	$2,300,980	$4,417,881
Cash from Receivables	$0	$0	$0
Subtotal Cash from Operations	$1,106,240	$2,300,980	$4,417,881
Additional Cash Received			
Sales Tax, VAT, HST/GST Received	$0	$0	$0
New Current Borrowing	$0	$0	$0
New Other Liabilities (interest-free)	$0	$0	$0
New Long-term Liabilities	$0	$0	$0
Sales of Other Current Assets	$0	$0	$0
Sales of Long-term Assets	$0	$0	$0
New Investment Received	$0	$0	$0
Subtotal Cash Received	$1,106,240	$2,300,980	$4,417,881
Expenditures	2001	2002	2003
Expenditures from Operations:			
Cash Spending	$30,941	$60,769	$113,591
Payment of Accounts Payable	$904,859	$1,233,699	$1,767,875
Subtotal Spent on Operations	$935,800	$1,294,468	$1,881,466
Additional Cash Spent			
Sales Tax, VAT, HST/GST Paid Out	$0	$0	$0
Principal Repayment of Current Borrowing	$0	$0	$0
Other Liabilities Principal Repayment	$0	$0	$0
Long-term Liabilities Principal Repayment	$0	$6,777	$7,486
Purchase Other Current Assets	$0	$0	$0
Purchase Long-term Assets	$36,000	$45,000	$55,000
Dividends	$0	$0	$0
Subtotal Cash Spent	$971,800	$1,346,245	$1,943,952
Net Cash Flow	$134,440	$954,735	$2,473,929
Cash Balance	$284,440	$1,239,175	$3,713,104

8.4 Projected Balance Sheet

Following is a copy of the company's projected balance sheet.

Business Solutions Consulting

Table: Balance Sheet

Pro Forma Balance Sheet			
Assets			
Current Assets	2001	2002	2003
Cash	$284,440	$1,239,175	$3,713,104
Other Current Assets	$20,000	$20,000	$20,000
Total Current Assets	$304,440	$1,259,175	$3,733,104
Long-term Assets			
Long-term Assets	$61,000	$106,000	$161,000
Accumulated Depreciation	$6,000	$12,300	$18,915
Total Long-term Assets	$55,000	$93,700	$142,085
Total Assets	$359,440	$1,352,875	$3,875,189
Liabilities and Capital			
Current Liabilities	2001	2002	2003
Accounts Payable	$28,236	$55,455	$103,658
Current Borrowing	$0	$0	$0
Other Current Liabilities	$0	$0	$0
Subtotal Current Liabilities	$28,236	$55,455	$103,658
Long-term Liabilities	$100,000	$93,223	$85,737
Total Liabilities	$128,236	$148,678	$189,395
Paid-in Capital	$99,500	$99,500	$99,500
Retained Earnings	($5,500)	$131,704	$1,104,696
Earnings	$137,204	$972,992	$2,481,597
Total Capital	$231,204	$1,204,196	$3,685,794
Total Liabilities and Capital	$359,440	$1,352,875	$3,875,189
Net Worth	$231,204	$1,204,196	$3,685,794

Appendix

Appendix Table: General Assumptions

General Assumptions	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Plan Month	1	2	3	4	5	6	7	8	9	10	11	12
Current Interest Rate	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
Long-term Interest Rate	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
Tax Rate	30.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%
Other	0	0	0	0	0	0	0	0	0	0	0	0

Appendix

Appendix Table: Profit and Loss

Pro Forma Profit and Loss		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Sales		$69,600	$72,975	$76,624	$80,455	$84,478	$88,702	$93,137	$97,793	$102,683	$107,817	$113,208	$118,869
Direct Cost of Sales		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Other		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Cost of Sales		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Gross Margin		$69,600	$72,975	$76,624	$80,455	$84,478	$88,702	$93,137	$97,793	$102,683	$107,817	$113,208	$118,869
Gross Margin %		100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Expenses:													
Payroll		$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000
Sales and Marketing and Other Expenses		$10,050	$10,050	$10,050	$10,050	$10,050	$10,050	$10,050	$10,050	$10,050	$10,050	$10,050	$10,050
Depreciation	5%	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500
Utilities	0%	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100	$100
Payroll Taxes	15%	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500	$7,500
Other		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Operating Expenses		$76,150	$76,150	$76,150	$76,150	$76,150	$76,150	$76,150	$76,150	$76,150	$76,150	$76,150	$76,150
Profit Before Interest and Taxes		($6,550)	($3,175)	$474	$4,305	$8,328	$12,552	$16,987	$21,643	$26,533	$31,667	$37,058	$42,719
Interest Expense		$833	$833	$833	$833	$833	$833	$833	$833	$833	$833	$833	$833
Taxes Incurred		($2,245)	($1,002)	($90)	$868	$1,874	$2,930	$4,038	$5,203	$6,425	$7,708	$9,056	$10,471
Net Profit		($5,238)	($3,006)	($270)	$2,604	$5,621	$8,789	$12,115	$15,608	$19,275	$23,125	$27,169	$31,414
Net Profit/Sales		-7.54%	-4.12%	-0.35%	3.24%	6.65%	9.91%	13.01%	15.96%	18.77%	21.45%	24.00%	26.43%

Appendix

Appendix Table: Cash Flow

Pro Forma Cash Flow		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Cash Received													
Cash from Operations:													
Cash Sales		$69,600	$72,976	$76,624	$80,456	$84,478	$88,702	$93,137	$97,793	$102,683	$107,817	$113,208	$118,869
Cash from Receivables		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Cash from Operations		$69,600	$72,976	$76,624	$80,456	$84,478	$88,702	$93,137	$97,793	$102,683	$107,817	$113,208	$118,869
Additional Cash Received													
Sales Tax, VAT, HST/GST Received	0.00%	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
New Current Borrowing		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
New Other Liabilities (interest-free)		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
New Long-term Liabilities		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Sales of Other Current Assets		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Sales of Long-term Assets		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
New Investment Received		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Cash Received		$69,600	$72,976	$76,624	$80,456	$84,478	$88,702	$93,137	$97,793	$102,683	$107,817	$113,208	$118,869
Expenditures		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Expenditures from Operations:													
Cash Spending		$2,011	$2,098	$2,189	$2,285	$2,386	$2,491	$2,602	$2,719	$2,841	$2,969	$3,104	$3,245
Payment of Accounts Payable		$55,729	$72,627	$73,410	$74,233	$75,096	$76,003	$76,955	$77,954	$79,004	$80,106	$81,263	$82,478
Subtotal Spent on Operations		$57,740	$74,725	$75,600	$76,518	$77,482	$78,494	$79,557	$80,673	$81,845	$83,075	$84,367	$85,724
Additional Cash Spent													
Sales Tax, VAT, HST/GST Paid Out		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Principal Repayment of Current Borrowing		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Other Liabilities Principal Repayment		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Long-term Liabilities Principal Repayment		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Purchase Other Current Assets		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Purchase Long-term Assets		$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000	$3,000
Dividends		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Cash Spent		$60,740	$77,725	$78,600	$79,518	$80,482	$81,494	$82,557	$83,673	$84,845	$86,075	$87,367	$88,724
Net Cash Flow		$8,860	($4,750)	($1,976)	$938	$3,996	$7,207	$10,580	$14,120	$17,838	$21,742	$25,841	$30,145
Cash Balance		$168,760	$154,009	$152,033	$152,970	$156,966	$164,173	$174,753	$188,873	$206,712	$228,454	$254,295	$284,440

Appendix

Appendix Table: Balance Sheet

Pro Forma Balance Sheet

Assets	Starting Balances	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Current Assets													
Cash	$150,000	$158,760	$154,009	$153,033	$152,970	$166,966	$164,173	$174,753	$188,873	$206,712	$228,454	$264,296	$294,440
Other Current Assets	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000
Total Current Assets	$170,000	$178,760	$174,009	$172,033	$172,970	$176,966	$184,173	$194,753	$208,873	$226,712	$248,454	$274,296	$304,440
Long-term Assets													
Long-term Assets	$25,000	$25,000	$31,000	$34,000	$37,000	$40,000	$43,000	$46,000	$49,000	$52,000	$55,000	$58,000	$61,000
Accumulated Depreciation	$0	$500	$1,000	$1,500	$2,000	$2,500	$3,000	$3,500	$4,000	$4,500	$5,000	$5,500	$6,000
Total Long-term Assets	$25,000	$27,500	$30,000	$32,500	$35,000	$37,500	$40,000	$42,500	$45,000	$47,500	$50,000	$52,500	$55,000
Total Assets	$195,000	$206,260	$204,009	$204,533	$207,970	$214,466	$224,173	$237,253	$253,873	$274,212	$298,454	$326,795	$359,440
Liabilities and Capital													
Current Liabilities		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Accounts Payable	$1,000	$17,498	$18,254	$19,047	$19,881	$20,756	$21,674	$22,639	$23,652	$24,715	$25,832	$27,004	$28,236
Current Borrowing	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Other Current Liabilities	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Current Liabilities	$1,000	$17,498	$18,254	$19,047	$19,881	$20,756	$21,674	$22,639	$23,652	$24,715	$25,832	$27,004	$28,236
Long-term Liabilities	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000
Total Liabilities	$101,000	$117,498	$118,254	$119,047	$119,881	$120,756	$121,674	$122,639	$123,652	$124,715	$125,832	$127,004	$128,236
Paid-in Capital	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500	$99,500
Retained Earnings	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)	($5,500)
Earnings	$0	($5,238)	($8,245)	($8,514)	($5,911)	($290)	$4,499	$20,614	$36,221	$55,496	$78,622	$105,791	$137,204
Total Capital	$94,000	$88,762	$85,755	$85,486	$88,089	$93,710	$102,499	$114,614	$130,221	$149,496	$172,622	$199,791	$231,204
Total Liabilities and Capital	$195,000	$206,260	$204,009	$204,533	$207,970	$214,466	$224,173	$237,253	$253,873	$274,212	$298,454	$326,795	$359,440
Net Worth	$94,000	$88,762	$85,755	$85,486	$88,089	$93,710	$102,499	$114,614	$130,221	$149,496	$172,622	$199,790	$231,204

Index

• A •

AAA-rated bond, 451–452
AACI (Accredited Appraiser Canadian Institute), 182
AA-rated bond, 451
accountant
  audits, 700
  budget team, 130–131
  business start-up, 652
  function, 721
  RRSP maximum contributions, 495
  types of, 721–722
accounting
  bookkeeping, 708–714
  cash flow projections, 720–721
  function, 707–708
  historical statements, 716–720
  internal controls, 715–716
  inventory, 714–715
accounts receivable, 663, 665
Accredited Appraiser Canadian Institute (AACI), 182
accrual accounting, 710–711
accurate budget, 94
address, home, 202, 272
adjusted gross income, 139, 142
adjustment date, 206, 234
adopted children, 601
advertising
  business market, 680–682
  home purchase, 98
  home-sale strategies, 264–269
  impulse spending, 126
  private sale of home, 250, 251
  spending influences, 38–39
adviceforinvestors.com (Web site), 472
Advocis (financial advisor association), 360
age of beneficiary, 588
age of investor
  annuities, 542–545
  C/QPP funds, 548
  life income funds, 547
  locked-in retirement accounts, 547
  needed retirement income, 507
  preretirement evaluation, 536
  RRSP goals, 515–516
  RRSP retirement deadline, 537
AGF (online mutual fund company), 463
aggressive growth fund, 318
aggressive investor, 410–411
AIM Short-term Income Fund (money market fund), 391
airfare, 54, 66
Alberta, 548
alcohol cost, 103, 116, 140
alimony payment, 104
All-Canadian Mutual Fund Guide (investment publication), 317
Altamira Financial Services Inc., 363, 364, 378, 463
alternate executor, 596
alternative minimum tax (AMT), 495
angel investor, 667–668
annual fee, 65, 68, 387
annual statement, 366
annuitant, 542
annuity, 514, 542–547, 580
apartment, 34
appliance, home, 118–119, 207
appraisal, home
  contract conditions, 204
  costs of sale, 235
  described, 181
  home pricing mistakes, 229–230
  versus inspection, 235
  mortgage paperwork, 170
  timing of, 264
Appraisal Institute of Canada, 183
appraiser, 181–183
appreciation, 396, 407
A-rated bond, 451
arrears of rent, 727
assessment of builder commitments, 184
asset
  balanced fund mix, 380–381, 383
  bankruptcy disadvantages, 105
  bankruptcy proceedings, 109–110
  business financing, 659
  business loan collateral, 663–664
  business plan preparation, 685
  debt-reduction strategies, 82–83
  decision to file bankruptcy, 110–111
  defined, 316

asset *(continued)*
income statement, 718–720
mortgage paperwork, 170
mutual fund overview, 318
net worth calculation, 10–14
total calculation, 82–83
will example, 624–627
asset, estate
disbursement before dying, 574–576
estate elements, 556
estate freeze, 576–578
estate-planning review, 561
estate's charitable donations, 579
executor functions, 593, 594, 595
asset allocation fund, 320
asset backed commercial paper, 517
assignment form, 109
assignment in bankruptcy, 730
assumable mortgage, 163–164, 238–239
attorney. *See* lawyer; power of attorney
auction, home, 194–195
audit, tax, 142–144, 700–701
average annual return, 329

• B •

back-end load, 321
balance sheet, 718–720
balanced fund
advantages, 380
asset mix, 380–381, 383
defined, 318
described, 320, 373, 380
disadvantages, 382–384
past performance, 382
RRSP savings, 381–382
bank
bond purchase, 455, 481
business loans, 661
money market fund selection, 391
mutual fund purchase, 352–356
power of attorney, 636–637
salaried advisors, 359–360
statements, 15–16, 352
bank account. *See also specific types*
broker services, 420
business accounting, 709–711
consolidation, 12
credit establishment, 62
debt-reduction plan, 103
hidden expenses, 115
savings strategies, 45
Bank Act, 663
Bank of Canada, 159, 476
banking industry, 377
Bankrate.com (Web site), 48
Bankruptcy and Insolvency Act, 729, 730
bankruptcy protection
alternatives to, 107–108
business bankruptcy, 729, 730–731
debt discharges, 106–107
decision to proceed, 110–111
disadvantages, 104–106
filing process, 108–110
bartering, 51–52, 103, 141–142
BBB-rated bond, 451
BB-rated bond, 451
bear market, 307, 395, 446
BellCharts (screening tool), 461
beneficiary
annuity benefits, 547
children as, 572
defined, 559
estate freeze, 576–578
estate tax bill, 583
executor functions, 594, 595
selection, 585–592
spouse as, 569–572
will example, 624–627, 629–630
beta measurement, 439–440, 469–470
blended payment, 160–161
Blue Book of Stock Reports (investment publication), 309
blue-chip company, 377–378, 386, 402, 451
BMO InvestorLine (discount broker), 429
bond. *See also specific types*
advantages, 385–386
defined, 311
described, 312, 384–385, 447–448
diversification, 317, 337–338
interest calculations, 448–450
online information resources, 476–477, 480–481
performance measures, 328–333
ratings, 312, 451–452
risks and rewards, 313, 314, 315, 450–451
RRSP options, 517
selection, 455
tax implications, 342
types of, 312–314
valuation process, 477–480
bond, purchase of
broker's commissions, 456–457
dollar cost averaging, 339
inflation, 382

preinvestment evaluation, 314–315
process, 481–483
salespeople, 357–363
selection, 387–388
bond, sale of
basic selling process, 482–483
decision to sell, 334–336
secondary-market sale, 455
bond fund
advantages, 385–386
defined, 318
described, 320, 373, 384–385
diversification, 317
selection, 387–388
BondCan.com (Web site), 476
bonus income, 522
book value, 470, 523
book-based bond, 453
bookkeeping, 708–714, 721
borderline expense, 74
bracket, tax, 568–569
bridge financing, 228, 285, 725
British Columbia, 245, 273
broker, investment. *See also specific types*
bond commissions, 456–457
bond purchases, 455
brokerage account options, 430–432
margin, 441–443
mutual funds, 347–351, 464–465
orders, 433–440
primary tasks, 420
selection, 425–427
short sales, 443–446
types of, 421
broker, real estate. *See* real estate agent/broker
budget
basic elements, 88–89
debt-reduction strategy, 85–95
evaluation, 94
expense categories, 113–115
function, 115
good money habits, 125–126
hidden expenses, 115–117
home purchase considerations, 153–155
income statement, 717
monthly, 120–124, 154–155
repair/replacement costs, 117–119
software tools for, 16–17
teamwork, 128–131
updates, 94–95, 98
worksheet, 17–21, 89–93
builder's agreement of purchase and sale, 184
bull market, 307, 395, 446
Bureau of the Public Debt, 482
business expense
audits, 142
cash flow projections, 656–657
categories, 712–713
income statement, 717–718
initial public offering, 397
legitimate types, 691–695
net worth calculation, 10–11
projections, 654–655
start-up company, 651–653
tax audits, 143
business income
cash versus accrual accounting, 710–711
categories, 711
estate-planning review, 550
income statement, 716–718
loan application, 674
net worth calculation, 10–11
projections, 654–655
business loan
application form, 673–674
business plan packaging, 688
business plan preparation, 676–687
business plan rationale, 671–673
estate-planning review, 550
inability to repay, 723–727
long versus short business plan, 675–676
references, 687
sources, 659–664
tax-savings tips, 142
business ownership
budget worksheet, 93
business taxes, 704–705
estate planning, 606–615
payroll taxes, 704
sales taxes, 701–704
start-up capital, 651–653
venture capitalists, 669
business plan
financing requirements, 671–673
format, 688
large versus small, 675–676
preparation, 676–687
references, 687
sample of, 759–779
software, 672
buyer, home, 202
buy-sell clause, 613

• C •

CA (Chartered Accountant), 361, 722
cable industry, 377
Canada Business Service Centre (CBSC), 673
Canada Business (Web site), 658
Canada Mortgage and Housing Corporation (CMHC), 100, 156, 167, 168
Canada Pension Plan (CPP) tax, 704
Canada Revenue Agency (CRA)
  audits, 142–144
  borrowing from your RRSP, 343, 530
  business expenses, 10–11
  business's inability to pay tax, 729
  estate tax filings, 563
  Home Buyers' Plan, 534, 535
  information resources, 73, 138
  instalment payments, 697, 698
  RRIF withdrawals, 541
  RRSP as collateral, 511
  RRSP maximum contributions, 492–495
  savings strategies, 46
  spousal RRSPs, 510
  tax-free savings accounts, 340
Canada Savings Bond (CSB)
  described, 313
  purchasing process, 482
  RRSP options, 452, 519–520
Canada Small Business Financing (CSBF) program, 660, 661
Canada/Quebec Pension Plan (C/QPP), 507, 548
Canadian Association of Financial Planners, 360
Canadian Association of Insurance and Financial Advisors, 360
Canadian Business (magazine), 310
Canadian Deposit Insurance Corporation (CDIC), 300, 427
Canadian Home Income Plan (reverse mortgage company), 241
Canadian Investor Protection Fund (CIPF), 427
Canadian MoneySaver magazine, 48
Canadian Mutual Fund Adviser (investment publication), 317, 321
Canadian Real Estate Association (CREA), 175, 244
Canadian Residential Appraiser (CRA), 182
Canadian Securities Administrators (CSA), 399, 425
Canadian Venture Capital Association, 669
Canoe Money (Web site), 99
capital
  business plan preparation, 685, 686–687
  business start-ups, 651–653, 657–658
  cost allowance, 565
  credit establishment criteria, 70
  initial public offering, 397, 398
  loss, 565, 567–568
capital gain
  bonds, 315
  conservative versus aggressive investor, 410, 411
  defined, 564, 565
  eligible capital property, 565–566
  estate tax, 564
  mutual funds, 316, 465
  real estate investment trusts, 325
  stock investment purpose, 408
capital gains tax
  business liabilities, 690
  business ownership after death, 608, 611
  calculation, 564–567
  contributions in kind, 520
  estate freeze, 576–578
  estate tax bill, 581
  estate-planning benefits, 558
  versus income tax, 564
  property disbursement before death, 575
  spousal transfers, 566–567
  V-Day cutoff, 566
capital loan, 659–664
capital property
  business accounting, 712–713
  capital gains tax calculation, 565
  defined, 564
  disbursement before death, 575
  spousal beneficiary, 570
  spousal rollovers, 566–567
car
  business expense, 694
  insurance, 74
  registration tax, 140
  repairs, 117
  trips, 53

car payment
  debt-reduction plan, 98, 104
  emergency expense, 132
  opportunity cost, 36
  total debt obligation, 76–79
  used cars, 55
carried forward contribution, 496
cash account, 431, 442–443
cash accounting, 710
cash flow projection, 656–657, 720–721
cash income, 143
cash reserve, 297, 370, 523
cash-flow-to-share-price ratio, 470
catch-up contribution, 496, 500–501
CBSC (Canada Business Service Centre), 673
CDIC (Canadian Deposit Insurance Corporation), 300, 427
Central Depository System (CDS), 453
Certified Financial Planner (CFP), 360
Certified General Accountant (CGA), 360, 722
Certified General Accountants of Canada, 138
Certified Management Accountant (CMA), 360, 722
certificate of completion, 210
charitable donation
  estate tax, 579–580
  expense categories, 113
  good-decision rewards, 41
  tax advantages, 46
  tax audits, 143
  tax records, 138
  will example, 625
charitable remainder trust, 580
Chartered Accountant (CA), 361, 722
chattel, 207, 253, 254, 277–278
chequing account
  automatic mutual fund purchase, 339
  business accounts, 710
  credit establishment, 62
  debt-reduction plan, 103
  line of credit, 662
  savings strategies, 45
child support, 78, 591
children
  business ownership after death, 608–610
  capital disbursements before death, 574–576
  custody at death, 597–605
  estate freeze, 577
  estate-planning benefits, 557
  financial teamwork, 129
  living will, 646
  RESP fund, 532–533
  RRSP beneficiaries, 572
  RRSP investment rationale, 490
  tax-savings tips, 142
  will example, 624–628
chimney inspection, 212
church, 131
churning, 423
CIBC Economics Online (Web site), 476
CIBC Investor's Edge (discount broker), 429
CIBC World Markets (underwriters), 398
CIPF (Canadian Investor Protection Fund), 427
classified ad, 198, 266–267
closed fund, 393
closed mortgage, 158, 162
closing date, of trade, 419
closing on home, 205, 228, 278, 284–285
closing price, 418
CMA. *See* comparative market analysis
CMA (Certified Management Accountant), 360, 722
CMHC (Canadian Mortgage Housing Corporation), 100, 156, 168
CNET Download.com (Web site), 672
co-branded credit card, 66
co-executor, 595
collateral
  business loans, 663–664, 725
  defined, 71
  RRSP as, 511
  short sales, 444
commercial loan. *See* business loan
commercial paper, 391, 517
commissioned advisor
  discount broker, 367
  full-service brokers, 422, 423
  stock salespeople, 357–358
Committee on Uniform Securities Identification Procedures (CUSIP), 456
commodity fund, 318
common stock, 307–309, 517–518
commute payment, 623
comparative market
  home purchase, 181
  home sale, 225, 228–229, 246, 250
comparison shopping, 116
compliance officer, 362

compounding, 293, 294, 379, 662
computer, 15, 34, 268
conditional discharge, 731
conditional sale, 226–228, 272–279
condition-related order, 436–440
condo
  costs of sale, 233, 234, 235
  disclosure statement, 259
  housing needs and wants, 182
  inspection, 210, 214–215, 233
  legal services, 185
  ownership costs, 34, 151
  retirement options, 549
  subject to sale clause, 282
  warranties, 219
conjugal relationship, 566
conservative investing, 410
consolidating accounts, 12, 68
consolidation order, 107
consultant, business, 672–673
consumer product industry, 377
consumer proposal, 107–108
contact information, 136
continuing power of attorney, 635–636
contract of purchase and sale, 183–184, 201–207, 272–279
contribution in kind, 519–520, 522
construction, home, 210–211
conventional discount brokers, 424
conventional mortgage, 156
conveyancing, 184, 253
co-owner, company, 400
corporate bond, 314
corporation
  bankruptcy, 730, 731
  business loans, 663, 664
  estate freeze, 578
  ownership after death, 606–612, 614–615
  tax liabilities, 696, 698
co-signer, 62, 111, 726–727
counteroffer, 205
coupon, bond, 311, 453
coupon, store, 52–53, 102, 142
cover, business plan, 688
CPP (Canada Pension Plan) tax, 704
C/QPP (Canada/Quebec Pension Plan), 507, 548
CRA (Canadian Residential Appraiser), 182
Craigslist (Web site), 194–195
CREA (Canadian Real Estate Association), 175, 244
credit
  bureau, 70
  counselling, 107, 131
  history, 70, 96, 105
  limits, 63
credit card
  acceptable debt level, 63–65
  alternatives to bankruptcy, 107–108
  balance transfers, 99
  bankruptcy proceedings, 107–110
  budget worksheet, 93
  business accounts, 710
  business financing, 660–661
  debt patterns, 79–80, 95–97
  debt reduction strategies, 67–68
  emergency expense, 132
  found money, 55
  gas cards, 53
  hidden expenses, 115, 116
  home sale considerations, 222
  low RRSP contributions, 496
  low-interest types, 99
  savings strategies, 45–46
  selection, 65–66, 99
  signs of trouble, 67
  spending records, 15, 16
  total debt obligation, 76–79
  two-card system, 65–66
credit card interest. *See* interest, credit card
credit establishment
  criteria, 69–70
  first-time credit, 62–63
  pros and cons, 61–62
credit report
  brokerage accounts, 431
  credit establishment, 70
  mortgage assumption, 239
  mortgage paperwork, 170
  mortgage questions, 172
  short sales, 444
credit union
  bond purchase, 481
  business loans, 661
  guaranteed investment certificates, 303
  personal loans, 99–100
  savings accounts, 300
creditworthiness, 431, 444
CSA (Canadian Securities Administrators), 399, 425
CSB. *See* Canada Savings Bond
CSBF (Canada Small Business Financing) program, 660, 661
curb appeal, 263–264
currency, 194
currency fund, 318
current liability, 719
current ratio, 470, 720

current yield, 315, 479–480
CUSIP (Committee on Uniform Securities Identification Procedures), 456
custody, of children, 597–605
customer credit, 665

• D •

day order, 434
DBRS (Dominion Bond Rating Service), 312
death. *See* estate planning
debatable expense, 74
debenture, 663
debt
  bankruptcy rules, 106–107
  categories, 70–71
  decision to file bankruptcy, 110–111
  defined, 69
  estate-planning benefits, 557
  executor functions, 594
  home sale considerations, 222
  instrument, 478
  margin loans, 442–443
  RRSP investment rationale, 490–491
  tax audits, 143
  total obligation, 76–79
  triggers, 79–80
  will example, 623–624
debt ratio
  calculation, 78–79
  debt-reduction strategies, 64, 67
  high-ratio mortgage insurance, 167
debt reduction. *See also* bill payment
  advantages, 63
  bankruptcy protection, 104–111
  budgets, 85–95
  credit card strategies, 67–68
  debt monitoring strategies, 64
  goal-setting strategies, 30
  payoff plan, 95–104
  priority setting, 81
  savings strategies, 47
  total assets, 82–83
debt-to-equity ratio, 470
declared partnership, 613
deduction, tax
  audits, 142, 143
  estate-planning considerations, 568
  itemized, 139
  paycheques, 119–120
  tax records, 138, 139
deemed disposition, 520, 565
deep-discount broker, 464
deferred profit-sharing plan (DPSP), 492–493
defined benefit plan, 492
defined contribution, 493
deflation, 382, 386
delivery charge, 116
demand loan, 662–663
dependant, 589–590
deposit, 203, 271–272, 665
depreciation, 565, 692
depression, 127
dining expense, 35
disabled family members, 534
disbursement, 252
dischargeable debt, 106, 107
disclosure statement, 257–259
discount, store, 54, 102, 126, 142
discount broker
  commissions, 367
  described, 423
  versus direct purchase, 370–371
  versus full-service broker, 421–423
  money market fund selection, 391, 392
  mutual fund purchase, 347–351, 464
  online trades, 429–430
  primary tasks, 420
  selection, 425–427
discretionary income
  bankruptcy filing, 106
  budget worksheet, 90
  debt reduction, 95–98
  decision to file bankruptcy, 110
  wants versus needs, 37–38
Disnat (discount broker), 429
distraining property, 727
diversified investments
  fund managers, 355
  mutual funds, 316–317, 369–370, 376
  rationale for, 376
  RRSP principles, 488
  stocks, 317, 337–338
dividend
  defined, 404
  versus interest, 408
  mutual fund basics, 316
  stock basics, 307
  stock investment function, 408–409
  stock screens, 468, 470–471
  stock tables, 416
  tax credit, 341
  tax rates, 696
  tax-savings tips, 142
  types of stock, 307, 308, 309
  yield calculations, 409
dividend date, 419
dividend fund, 392

divorce
beneficiary provisions, 590–591
decree, 136
guardianship of children, 598, 599
home sale, 223
spousal RRSPs, 510
dollar cost averaging, 338–339, 498
Dominion Bond Rating Service (DBRS), 312
Dow Jones Industrial Average (DJIA) (U.S. index), 307, 331–332
DPSP (deferred profit-sharing plan), 492–493
dual agency, 176

• E •

EAP (Employee Assistance Program), 131
earnings
defined, 418
multiple, 418
per share, 471
report, 417
RRSP withdrawal, 531
stock screens, 468, 471
easement, 202–203
eaves, inspection of, 212
eBay (auction site), 194–195
EI (Employment Insurance) tax, 704
electrical system, 213, 259
electronic tax filing, 144
emergency fund
debt-reduction plan, 98
repair/replacement costs, 117–119
RRSP withdrawal, 531
savings advantages, 43–44
savings strategies, 46
emerging market/country fund, 319, 392–393
Employee Assistance Program (EAP), 131
employee salary, 694–695
employment
bankruptcy disadvantages, 105
bond purchase, 481
home purchase versus renting, 149
pension plans, 492–493
reasons to sell home, 222
RRSP contributions, 493–495, 497–499, 526–527
RRSP deadline, 538
RRSP deductions, 498–499, 499
second job, 56–57, 103
tax deductions, 119–120
telecommuting, 55
U.S. employees, 512
Employment Insurance (EI) tax, 704
encroachment, 258
enduring power of attorney, 635–636
energy efficient home, 262
eNorthern (broker), 430
entertainment expense, 53–54, 127, 712
Equifax (credit reporting company), 70
equipment, business
business financing, 658, 663
collateral, 664
inability to repay loans, 726
legitimate expenses, 691–692
Equis International (software company), 473
equity, home
debt-reduction plan, 101
mortgage prepayment, 237
rental versus home purchase, 323
retirement income, 549–550
reverse mortgages, 241
equity fund, 317–318, 373–379
escape clause, 276–277
essential expense
budget worksheet, 90, 93
categories, 72–73, 113–114
defined, 72
essential fixed expense, 72, 113–114
essential variable expense, 72, 102, 113, 114
estate
annuity benefits, 547
claims for support, 590, 591
described, 555–557
legal rights, 557
reverse mortgages, 241
estate planning
advantages, 557–558
beneficiary selection, 585–592
business ownership, 606–615
custody of children, 598–605
example of will, 619–621
executor functions, 593–595
executor selection, 595–597
helpful professionals, 561–562
intestate death, 617
lawyer form, 735–745
legal fees, 561
living will, 642–647
power of attorney, 633–642
standard will, 618
timing, 560–561

tools, 558–559
updated will, 618
estate tax
annual filing, 563
charitable donations, 579–580
estate freeze, 576–578
gifts before dying, 574–576
payments, 580–583
principal residence, 572–574
spouse as beneficiary, 569–572
types of, 564–569
will example, 623–624
estate trustee with a will. *See* executor
estimated expense, 93
ethical fund, 318
ethics
executor selection, 597
financial advisors, 360
home sale negotiations, 285
real estate agents, 174
stock market regulation, 398, 399
E*TRADE Canada (broker)
described, 424
general bond information, 480
online mutual fund purchase, 464
online trades, 429, 430
exclusive listing, 255
executive recruiting, 397
executive summary, 688
executor
defined, 558
estate tax, 582
estate-planning review, 560
example will, 622–623, 628–631
instruction form, 747–752
intestate death, 617
inventory form, 753–757
selection, 595–597
standard will provisions, 618
exhibition, investment, 362
exit strategy, 669
expense. *See also* liability; *specific types*
budget evaluation, 94
budget worksheet, 90–93
categories, 72–76, 113–114
debt patterns, 79–80
debt-reduction plan, 95–105
decision to file bankruptcy, 110–111
defined, 72
housing budget, 153–155
monthly budget, 120–124
mutual fund fees, 321
sale of home, 231–236, 249–251
tax records, 138–139
total debt obligation, 76–79
exterior home inspection, 212, 214–215

• F •

face value, 311, 315, 449
factoring, 665
fair market value (FMV), 229, 566
family
bankruptcy disadvantages, 105
beneficiary selection, 585–592
budget elements, 89
business financing sources, 659–660
business ownership after death, 607–613
debt-reduction plan, 104
decision to file bankruptcy, 111
discounter referrals, 350
as employees, 694
estate-planning benefits, 557, 558
executor selection, 595–597
financial teamwork, 128–129
guardianship of children, 599–605
Home Buyers' Plan, 534
home purchase versus renting, 149
lawyer recommendations, 251
living will, 643–647
loan from, 104, 130
power of attorney witnesses, 641
principal residence, 571–574
reverse mortgages, 241–242
RRSP investment rationale, 490
feature sheet, 268–269
Federal Reserve Bank, 477, 481–482
federal tax rate, 696
Fidelity Funds (online mutual fund company), 463
FIFO (First In, First Out) method, 715
52-week high/low columns, of stock table, 415
filing system, 134, 138, 709, 713
finance charge, credit card, 65, 66, 67
financial advisor
bond funds, 387
broker's role, 420, 422, 424
commissions, 321
versus discount broker, 348

financial advisor *(continued)*
power of attorney, 637
selection, 361–363
types of, 356–361
financial management software
accounting tools, 714
budget tools, 16–17
business plans, 672
expense-tracking methods, 15, 16–17
inventory tracking, 715
organized records, 134
stock screeners, 473
Financial Planners Standards Council (FPSC), 360
financial statement, 674, 716, 721. *See also specific documents*
First In, First Out (FIFO) method, 715
five-year goal, 25–26, 31
fixed rate mortgage
portable mortgages, 239–240
questions for broker, 172
versus variable rate mortgage, 158, 162
fixed term annuity, 580
fixed-income investment, 516
fixture, household, 207
flat yield curve, 479
flood inspection, 212–213
FMV (fair market value), 229, 566
food cost, 35, 102, 103, 116
foreclosure, 98, 166
foreign employment, 512
foreign money market fund, 391
found money
debt-reduction plan, 101–104
frugal living tips, 55
RRSP contributions, 522
savings strategies, 46–47
tax audits, 143
foundation inspection, 212
FPSC (Financial Planners Standards Council), 360
freelance bookkeeper, 714
freight charge, 358
front load, 321
fuel tax, 140
full-service broker
versus discount broker, 421–423
online mutual fund purchase, 464
selection, 427
fund company, 363–371
Fund Library (Web site), 459–460
fund managers
balanced funds, 383–384
bank funds, 355
fees, 321
function, 518
risk taking, 378–379
tenure, 322
types of funds, 318–320
Fund Selector (screening tool), 461
funeral, 558, 593
furniture cost, 118–119, 265

• G •

gas credit card, 53
general power of appointment, 623
general power of attorney, 636–637
general security agreement, 663
Genworth Financial, 167, 168
GIC. *See* guaranteed investment certificate
gift, property
described, 559
disbursement before death, 574–576
estate freeze, 577
will example, 624–626
gift money, 46–47
gilt-edged bond, 451–452
global fund
described, 319
RRSP investments, 392–393, 496–497
selection, 387
The Globe and Mail, 310, 365, 379, 414
globefund.com (Web site), 459, 460
GLOBEinvestor.com (Web site), 472
goal, business, 677–678
goal, financial
debt-reduction budget, 85–88
described, 23–24
discount brokers, 423
examples of, 24
financial security, 24–25, 30
five-year plan, 25–26, 31
flexible plans, 28–30, 87
full-service brokers, 422
investment performance, 334
investment plan, 295–296
prepurchase considerations, 31
priority setting, 26–28, 81
RRIF conversion, 551
stock selection, 403–407
time management, 28
gold fund, 318, 392
goods and services tax (GST)
business ownership, 702–704
credit cards, 67

defined, 137
expense accounting, 713
home sale expenses, 236
lawyer fees, 252
tax-savings tips, 141
good-till-cancelled (GTC) order, 434–435, 438
government bond. *See also specific types*
annual fees, 387
average returns, 292
issuers, 450
ratings, 451–452
selection, 387–388
types of, 313–314
government loan, 666
Government of Canada bond, 313
gradient inspection, 212
gratuity, 116, 143
Greenline Mutual Funds (online mutual fund company), 463
gross income, 27
growth fund, 318
growth and income fund, 319
growth stock, 308–309, 468
GST. *See* goods and services tax
GTC (good-till-cancelled) order, 434–435, 438
guarantee, 660
guaranteed investment certificate (GIC)
advantages, 303
described, 302–303
market-linked versions, 304
versus money market funds, 389–390
performance assessment, 328–333
RRSP options, 516
versus strip bonds, 454
tax implications, 341
guaranteed term, 546
guardianship, 597–605

• H •

harmonized sales tax (HST), 67, 137, 704
HBP (Home Buyers' Plan), 534–536
health care, 642–647
heating inspection, 213
heavy trader, 367, 368
high-ratio mortgage, 156, 167–168
high-yield bond, 388, 452
holdover clause, 245
Home Buyers' Plan (HBP), 534–536
home equity loan, 100–101
home improvement. *See* renovation, home
home insurance, 74, 151, 278
home office, 142, 693, 712
home purchase. *See also* mortgage; real estate
affordability calculation, 225–226
appraiser's function, 181–183
buyer fears, 147
contract of purchase, 201–207
housing needs and wants, 182–186
market conditions, 149, 152–153
offline shopping, 195–199
online shopping, 192–195
ownership expenses, 148, 150–151
principal residence, 571–574
real estate agents/brokers, 174–181
versus renting, 148–149, 323
RRSP investment rationale, 490
RRSP withdrawals, 534–536
timing concerns, 148
home sale. *See also* real estate
alternatives to sale, 221–222
assumable mortgage, 163–164
backup offers, 286–287
contract details, 269–271
disclosure statements, 257–259
estimated costs, 231–236, 249–251
interest buy-downs, 165
lawyer services, 251–254
listing service, 177, 254–257
marketing strategies, 264–269
mortgage options, 236–242
multiple offers, 285–286
negotiations, 269, 272, 279–285
pricing, 224–231, 245–246, 250
principal residence, 571–574
real estate agent selection, 243–248
reasons to sell, 222–223
retirement options, 549

home sale *(continued)*
sale by owner, 248–251, 255, 267, 269
seller's fears, 221
timing of, 223–228
vendor take backs, 164
housing cost
costs and benefits, 34–35
debt-reduction plan, 98, 101, 104
foreclosure, 98, 166
HSBC (broker), 429, 464
HST (harmonized sales tax), 67, 137, 704
Human Resources and Social Development Canada (HRSDC), 548, 666
hybrid fund, 318

• I •

ICAP GovPX (Web site), 476
IDA (Investment Dealers Association of Canada), 361, 425
identification, will, 622
impulse spending, 22, 126–128
income
budget worksheet, 17–21, 90
capital loss, 567
debt ratio, 64, 67, 78–79
debt-reduction strategies, 82
dividend-paying stocks, 408–409
estimated retirement funds, 507, 508
extra money, 56–57
goal-setting strategies, 27, 30
housing budget, 153–155
monthly budget, 120–124
mortgage assumptions, 239
mortgage paperwork, 170
RRSP maximum contributions, 492, 493–494
savings strategies, 45
sources, 10–11, 56–57
splitting, 510
tax records, 138
total debt obligation, 78–79
income fund, 317, 318
income statement, 716–718
income tax
bonds, 342
brackets, 568–569
business expenses, 691–695
business profit and revenue, 690–691
business records and audits, 699–701
business's inability to pay, 729
calculation, 568
versus capital gains tax, 564
complexity of, 137
corporations, 695, 698–699
forms, 138, 139
Home Buyers' Plan, 535
itemized deductions, 139
mutual funds, 465
organized records, 138–139
penalties, 699
preparation guide, 137–138
property disbursement before death, 576
RESP withdrawals, 532
RRIF conversion, 539, 551
RRIF withdrawals, 540
RRSP deductions, 498–499, 501–502
RRSP investment rationale, 491
RRSP withdrawals, 342–343, 530
savings accounts, 340–341
sole proprietorships, 695–698
tax-savings tips, 140–142
Income Tax Act, 608
index, 328–333
index fund, 318, 320, 354
indexed annuity, 546
Individual Retirement Account (IRA), 512
Industrial Research Assistance Program, 666
industry, 377, 678–679
Industry Canada Financing, 666
inflation
annuities, 546
balanced funds, 382
bond funds, 387
bonds, 385
RRIF challenges, 542
RRSP growth expectations, 505–506
savings accounts, 300
ING Direct (online bank), 303
initial public offering (IPO), 306, 396–397
inspection, home
versus appraisal, 235
condo sale, 233, 235
described, 208–209
disclosure statement, 257, 258, 259
housing needs and wants, 182

inspector selection, 209–210
newly built home, 210–211
offer to purchase clause, 274–275, 281
process, 211–215
timing of, 264
inspector, bankruptcy, 109
institutional broker, 420
insulation, 213
insurance. *See specific types*
interest, credit card
business financing, 661
debt-reduction plan, 95–96, 99
described, 65, 66, 67
emergency expense, 133
hidden expenses, 115, 116
interest, investment. *See also* return on investment
annuities, 544, 545, 546
bonds, 312–314, 315, 448–450
cash accounts, 431
compounding benefits, 294
versus dividends, 408
goal setting, 296
guaranteed investment certificates, 302, 303, 304
loan for RRSP contribution, 499–500
mutual funds, 316, 321
risks and rewards, 292–293
RRIF value, 540–542
RRSP withdrawals, 531
savings accounts, 300
tiered accounts, 301
interest, mortgage. *See* mortgage interest
interest rate
business loans, 662
credit union loan, 100
home equity loan, 100
housing market, 153
sub-prime mortgages, 101
unsecured loan, 71
intermediate goal, 87, 406
internal controls, 715–716
international fund. *See* global fund
Internet discount brokers, 424
interior home inspection, 212–214, 215
intestate death, 592, 617
inventory, business
accounting, 712, 714–715
collateral, 663, 665
inverted yield curve, 479
investment. *See specific types*
Investment Dealers Association of Canada (IDA), 361, 425
investment performance
decision to sell, 334–336
goal setting, 334
guaranteed investment certificates, 328
indices, 328–333
mutual funds, 317, 328–333
rational evaluations, 333–334
savings accounts, 327
stocks and bonds, 328–333
tiered accounts, 327
The Investment Reporter (investment publication), 309
Investor's Business Daily (investment publication), 414
Investor's Digest of Canada (investment publication), 309, 321
invoice, 708–709
IPO (initial public offering), 306, 396–397
IRA (Individual Retirement Account), 512
irrevocable time, 205, 271
issuer
bond maturity, 448
defined, 311
government-guaranteed bonds, 450
prepurchase evaluation, 314–315
itemized deductions, 139

• J •

job skill, 56
joint custody, 598
joint life annuity, 580
joint owner, 559, 574, 587
joint tenancy, 202
journal entry, 713
junk bond, 314, 451, 452

• L •

labour venture fund, 393
land survey, 215–217
land transfer tax, 140, 184
landlord, 727–728
landscaping, 263–264
large-cap stock, 402, 404, 410, 417
Last In, First Out (LIFO) method, 715
lawsuit, 417, 663
lawyer
audits, 700
beneficiary provisions, 590, 591

lawyer *(continued)*
business start-up, 651–652
estate freeze, 578
estate-planning costs, 561
estate-planning form, 735–745
home purchase, 183–186, 198, 204
home sale expenses, 232–233, 251–254
home sale negotiations, 279–280
living will, 645
power of attorney, 634, 638–639, 640
leased equipment, 726
leasehold improvement, 659
legal fee, 252, 561
letters probate, 593
leverage, 441
liability. *See also* expense
budget worksheet, 17–21
business plan preparation, 685
defined, 14
estate elements, 556
goal-setting strategies, 30
income statement, 718–720
initial public offering, 397
mortgage paperwork, 170
net worth calculation, 14–21
trading volumes, 417
life annuity, 580
life income fund (LIF), 547–548
life insurance
beneficiary provisions, 587, 591
business ownership after death, 613
described, 559
estate legalities, 556
estate tax, 579, 582
expense categories, 74
mortgage, 168
retirement strategy, 542–543
Lifelong Learning Plan (education plan), 533
LIFO (Last In, First Out) method, 715
light trader, 367
limit order, 436, 440
limited partnership (LP), 514
line of credit, 166–167, 662
liquid asset, 12, 454, 488
liquidating assets, 12, 97, 98, 516
liquidator. *See* executor
listing contract, 254–257
living will, 136, 642–647
load, 321, 353, 363
loan. *See also specific types*
alternatives to bankruptcy, 107–108
bankruptcy rules, 106–107
cheaper debt, 99–101
debt categories, 71
decision to file bankruptcy, 110–111
emergency expense, 132
from family, 104, 130
hidden expenses, 116
RRSP as collateral, 511
RRSP contributions, 499–501, 522
RRSP swap, 520
tax-savings tips, 142
locked-in retirement account, 547–548
long-term bond, 388, 454–455
long-term goal, 25, 86–88, 406–407
long-term liability, 719
loss, capital, 567–568, 696
lump-sum RRSP contribution, 497–498

• M •

Mackenzie Financial Corp. (investment company), 383, 463
managed asset, 518
management expense ratio (MER), 321–322, 465
manager, business, 684
mandate, 636
mandatory, 636
MAP (minimum annual payout), 539–540
margin, buying on, 441–443
margin account, 431–432
margin call, 442
market, target, 679–682
market analyst, 306
market capitalization, 401–402, 468, 471
market order, 436
market study, 680
market value, 523
marriage
beneficiary provisions, 588–591
capital gains tax, 566–567
certificate, 136
estimated retirement income, 508
RRSP goals, 515
RRSP investment rationale, 489, 490
spousal beneficiary, 569–572
spousal RRSP, 509–510
maturity, bond
bond ratings, 312
defined, 311

interest calculations, 448
prepurchase evaluation, 315
purchases, 455
secondary-market sale, 455
maturity, GIC, 328
Mawer Investment Management (fund company), 364
medical treatment, 132, 138, 642–647
medium trader, 368
mega-cap stock, 402
mental capacity
living will, 642–643
power of attorney, 634, 635, 638–642
MER (management expense ratio), 321–322, 465
MetaStock (screening tool), 473
micro-cap stock, 401
micro-credit loan, 664
Microsoft Money (software), 16
Microsoft MoneyCentral Investor (screening tool), 462, 472
mid-cap stock, 402, 404
minimum annual payout (MAP), 539–540
minor beneficiary, 629–630
MLS. *See* Multiple Listing Service
money market fund, 318, 320, 374, 388–392
money purchase plan, 493
MoneyCentral Fund Finder (screening tool), 462
Morningstar (rating organization), 160, 461, 462
mortality table, 546
mortgage. *See also* home purchase
blended payments, 160–161
brokers, 160, 169–172
business financing, 661
business's inability to pay, 728
calculators, 240
debt-free living, 63
debt-reduction plan, 98, 100–101, 103
elements of, 156–161
emergency expense, 132
home sale expenses, 233–234
home sale options, 236–242
housing budget, 153–155
housing market, 153
insurance, 167–168, 172
lawyers, 253
listing contract, 256
mutual fund purchase, 353
offer to purchase, 274, 281
opportunity costs, 34
options, 162–167
paperwork, 169–171, 185
payoffs, 161, 162, 163, 237–238
principal, 157
refinance options, 100
versus rent, 148–149
RRSP investment options, 518–519
RRSP investment rationale, 489–490
sources of, 169
term, 161
types of, 156
mortgage interest
assumable mortgage, 163–164
blended payments, 160–161
builder/developer buy-down, 164–165
described, 157
fixed rate versus variable rate, 158–160, 162
home sale options, 238, 239–240
mortgage options, 162–167
portable interest, 163
questions for broker, 171–172
refinancing, 100
RRSP regulations, 519
sub-prime mortgage crisis, 101, 106, 166
Motley Fool (Web site), 473
moving expense, 139, 234–235, 549
MSN Investor (screening tool), 461
multiple, 418
Multiple Listing Service (MLS)
advertising outlet, 268
described, 192–193, 255
listing contract, 254–257
listing details, 196–197
real estate agent search, 177, 178, 180
search options, 193–194
municipal bond, 314
municipal restriction, 277
mutual fund. *See also specific types*
advantages, 375
analysis, 320–322
brokers, 347–351, 464–465
decision to sell, 334–336
defined, 316
described, 316

mutual fund *(continued)*
direct purchase, 363–371, 463
diversification, 316–317, 337–338, 369–370
dollar cost averaging, 339
online purchase/sale, 463–465
online screening, 459–463
performance measures, 317, 328–333
purchase from bank, 351–356
RRSP options, 518
salespeople, 356–363, 363, 364
tax implications, 341
types of, 317–320
Mutual Fund Dealers Association of Canada, 361

• N •

Name column, of stock table, 416
Nasdaq Composite Index (U.S. index), 332, 472
National Angel Organization, 668
National Bank Discount Brokerage, 429
national fund, 319
National Post FP Investing (magazine), 310, 414
National Research Council, 666
NAVPS (net asset value per share), 316
needs, personal, 33–37
basics, 33–37
negotiating deals, 51, 55, 279–285
net asset value per share (NAVPS), 316
Net Change column, of stock table, 419
net income, 27, 45, 64
net profit, 230–236, 674
net worth calculation
total assets, 10–14
total expenses, 14–21
new home construction, 210–211, 217–218
New York Stock Exchange, 306
newspaper
broker selection, 427
equity fund analysis, 379
home purchase, 198
home sale, 266–267
stock tables, 414–419
no-load fund, 321, 363–365
nondischargeable debt, 106, 107
nonessential expense
budget evaluation, 94
budget worksheet, 90
debt-reduction plan, 101
decision to file bankruptcy, 110
defined, 73
examples, 114–115
notary, 183, 185, 251
Notice of Assessment (RRSP contribution form), 492
notice of intention, 730
notice to invoke time clause, 276

• O •

offer to purchase a home, 201–207
Office of the Public Guardian and Trustee, 557
office supplies, 691, 692
Old Age Security (OAS) payment, 510
online banking, 16
online investing service, 427–430
Ontario Real Estate Association, 270
open fund, 393
open house, 179, 198–199, 268–269
open listing, 255
open mortgage, 162
operating expense, 654–657, 659
operating loan, 661
opportunity cost, 34–35, 40
option account, 432
order, stock, 433–440
organ donation, 558, 645
organization records, 133–139
owner's equity, 719

• P •

PA (pension adjustment) factor, 492, 493
paid-up capital, 705
painting, home, 262, 264
par value, 311, 453, 479
partial payment, 67
partnership
bank accounts, 709
bankruptcy, 730
ownership after death, 606, 613–614
tax liabilities, 695–698
part-time work, 538
paycheque
extra money, 56–57
monthly budget, 120–124
net worth calculation, 10
RRSP deductions, 498–499

savings strategies, 45, 481
tax deductions, 119–120, 704
payroll savings plan, 481
payroll tax, 704
P/B (price-to-book value) ratio, 310
P/E ratio. *See* price-to-earnings ratio
PEG ratio, 311
pension adjustment (PA) factor, 492, 493
pension plan
estate legalities, 556
estimated retirement income, 507
RRSP contributions, 492–493
tax credit, 510
performing arts, 53, 54
personal loan, 71
personal stockbroker, 421
personality type
broker selection, 426
described, 21–22
spending habits, 115
stock investments, 404, 410–411
pest inspection, 236, 259
Petro-Canada (company), 439
pledged asset, 511
point-of-sale system, 715
pooled fund, 393
portable mortgage, 163, 239–240
portfolio
defined, 316
diversification, 316–317, 337–338, 369–370
equity funds, 374, 376
mutual fund analysis, 322
mutual fund trades, 367–369
retirement decisions, 550
sector funds, 319
positive yield curve, 479
possession date, 206
power of attorney
described, 633–634
preparation, 638–642
regional terminology, 634–635
types of, 635–638
pre-approved mortgage, 172, 281
pre-built stock screen, 473
pre-completion deficiency inspection, 10
preferred share, 308, 518
prepayment penalty
debt-reduction plan, 98
home sale expenses, 234
home sale options, 238
mortgage options, 162, 163
price-to-book value (P/B) ratio, 310
price-to-earnings (P/E) ratio
described, 310, 311
stock screens, 468, 471
stock tables, 418
price-to-growth flow ratio, 311
price-weighted index, 332
primary underwriter, 397
prime rate, 159, 166, 501
principal
business loan, 662
mortgage loan, 157, 160–167, 237
residence, 572–574
resident exemption, 323
priority setting, 26–28, 81, 186–192
privacy legislation, 171
private home sale, 248–254, 267
probate fee, 558
profit, business
business plan preparation, 685
income statement, 717–718
loan application, 674
net profit, 230–236, 674
stock analysis, 310, 311
stock dividends, 307, 308
tax implications, 10–11, 695
profit, on home sale, 230–236
promissory note, 577, 660
property inventory, 594
property sale, 577–578, 582, 628
property tax
business ownership, 705, 729
home ownership considerations, 151
home sale expenses, 234
reverse mortgage options, 242
prorated warranty, 118
provincial bond, 314, 388
provincial law society, 251
provincial real estate association, 202
provincial restriction, 277
provincial sales tax (PST)
business ownership, 701–702
credit card costs, 67
defined, 137
expense accounting, 713
provincial tax number, 702
provincial tax rate, 696
proxy ballot, 400
PST. *See* provincial sales tax
public relations, 681

Public Service Enterprise Group (company), 439
public trustee, 588
purchase money security interest, 665
purchase price, home, 203

• Q •

Quicken (software), 16

• R •

RBC Direct Investing (broker), 430
RBC Dominion Securities (broker), 421
real estate. *See also* home purchase; home sale
  investment properties, 322–325
  power of attorney, 640
  risks and rewards, 322
  transfer tax, 140, 184
  weeklies, 198
real estate agent/broker
  benefits of, 175
  buyer's versus seller's agent, 175–176
  commissions, 232, 244–245, 249
  defined, 174
  dual agency, 176
  home sale pricing, 225
  home shopping tips, 195–196, 198–199
  listing contract, 256
  role in home purchase, 179–181
  role in home sale, 243–248
  selection, 174, 176–179, 243–248
  signs of poor agent, 180
real estate fund, 318, 392
real estate investment trust (REIT), 324–325, 393
reassessment notice, 701
receipt, 138, 709
recession, 382
record keeping
  bookkeeping tasks, 708–714
  business taxes, 699–701, 704
  income tax records, 138–139
  organization of records, 133–136
  tax audits, 142, 143
  tax savings, 141
recourse factoring, 665
refund, tax
  deduction amounts, 119–120
  insufficient RRSP contributions, 522
  loan for RRSP contribution, 500
  RRSP deductions, 501–502
refund of premium form, 571
regional fund, 319
Registered Education Savings Plan (RESP)
  basic rules, 532
  beneficiary provisions, 587, 589
  estate tax, 579
  Lifelong Learning Plan alternative, 533
  RRSP combination, 532–533
  RRSP rollovers, 500
  spousal distributions, 571–572
  tax-savings tips, 141
registered retirement income fund (RRIF)
  conversion of RRSP, 342, 538–539, 551
  described, 539
  retirement decisions, 550
  withdrawal rules, 539–542
REIT (real estate investment trust), 324–325, 393
religious group, 131
remainder trust, 580
Renaissance Investments (mutual fund company), 463
renovation, home
  home pricing mistakes, 231
  home sale clauses, 277
  home sale expenses, 233
  home sale preparations, 261–264
  selling alternatives, 222
rent expense
  business's inability to pay, 723–728
  debt ratio calculation, 78
  versus home ownership, 148–149, 323
  housing costs and benefits, 34
rental unit
  business's inability to pay, 727
  contract of purchase and sale, 278–279
  disclosure statement, 258
  investment options, 324
  lawyer fees, 252
  net worth calculation, 11
  predeath disbursement, 576
  retirement options, 549–550

repair/maintenance cost
  debt-reduction plan, 102
  disclosure statement, 257–259
  emergency funds, 117–119
  general home ownership costs, 148, 150, 151
  home inspection process, 208–215
  home pricing mistakes, 231
  home priorities, 189–192
  home purchase contract conditions, 204
  home renovation, 222
  home sale expenses, 233, 235
  home sale negotiations, 283–284
  home sale preparations, 261–264
  tax records, 139
  warranties, 217–219
replacement cost, 117–119
repossession, 727
residence, legal, 207
residual, 453, 579
RESP. *See* Registered Education Savings Plan
resume, 684
retail industry, 377
retainer, 665
retirement
  advantages to saving, 44
  business ownership, 610, 613
  financial decisions, 550–551
  home sale, 231, 240–242
  inflation effects, 506
  planning steps, 513
  preretirement evaluation, 536
  required income estimates, 506–508, 733–734
  RRSP deadline, 537
  strip bonds, 454
retirement account. *See specific types*
retiring allowance, 495
return on equity (ROE), 471, 720
return on investment. *See also* interest, investment; yield
  angel investors, 667
  balanced funds, 380, 381
  bond funds, 385, 452
  defined, 292, 329
  direct mutual fund purchase, 365
  goal setting, 296
  home renovations, 262
  indices, 329
  money market funds, 388–389, 390
  mutual fund trades, 368
  real estate investment trusts, 324–325
  regular RRSP contributions, 498
  risks and rewards, 291–293
  RRIF accounts, 540–541, 551
  RRSP growth expectations, 504–505
  venture capitalists, 669
revenue. *See* business income
reverse mortgage, 240–242, 549
revocation, 622, 640
reward, credit card, 66
right of testamentary freedom, 589
right of way, 202–203
risk taking
  annuities, 545
  balanced fund, 380–381
  bonds, 313, 314, 315, 450–451
  equity funds, 374–376
  fund managers, 378–379
  goal-setting strategies, 29–30
  inexperienced investors, 408
  investment performance evaluation, 333
  investment rewards and drawbacks, 291–293
  market capitalization, 401–402
  money market funds, 389–390
  mutual fund analysis, 322
  Nasdaq index, 332
  real estate investing, 322, 325
  RRSP strategy, 513
  short sales, 444
  short-term versus long-term investments, 334
  stock analysis, 403
  stock categories, 401–407
  value versus growth stock, 309
ROE (return on equity), 471, 720
rollover
  bond purchase, 482
  RRSP to RESP, 500
  spouse's capital property, 566–567
roof inspection, 212
Royal Bank, 301
royalty trust, 393
RRIF. *See* registered retirement income fund

RRSP savings
advantages, 44, 46
age of investor, 495, 515–516, 537
application form, 349
balanced funds, 381–382
basic investing principles, 487–488
beneficiary provisions, 587
bond purchases, 455
bond ratings, 452
borrowing from, 342–343, 529–536
business financing, 659
catch-up contributions, 496, 500–501
as collateral, 511
common mistakes, 508
contributions from loans, 499–500
debt-reduction plan, 98
decision-making challenges, 503–504
described, 487
discounters, 349, 350
dollar-cost averaging, 498
employer's company shares, 526–527
estate tax, 579
estimated retirement income, 506–508, 733–734
foreign holdings, 496–497
global funds, 392–393
growth expectations, 504–505
inflation effects, 505–506
liquidity, 491
married investors, 509–510, 571–572
maximum contribution, 491–496, 520–522
paycheque deductions, 498–499
purchase from bank, 353
rationale for, 489–491
versus real estate investing, 324
regular versus lump sum contributions, 497–498
regular reviews, 522–523
RESP rollovers, 500
RRIF conversion, 342, 538–539, 551
savings strategies, 46, 141
specialty funds, 392
statements, 523–526
strip bond investment, 454
suitable investments, 514, 516–520
tax records, 138
tax-deductible contributions, 340–343, 501–502, 512
Rule of 72 (compounding calculation), 294

• S •

salary
business plan preparation, 684
financial advisors, 359–360
increases, 56, 103
legitimate business expenses, 692, 694–695
payroll taxes, 704
sale clause, 275–276, 281
sales
charge, 321
estimate, 654–655
strategy, 681
sales tax. *See specific types*
savings
advantages, 43–44
business financing, 659
debt-reduction plan, 97–98
diversified investments, 337–338
first step to investing, 297
net worth calculation, 11–12
on-the-job options, 44
performance assessment, 327
personality types, 21
repair/replacement fund, 117–119
RRSP options, 516
strategies for saving, 45–48, 120
tax implications, 340–341
types of accounts, 300–301
Saxon Group of Funds (fund company), 364
Sceptre Investment Counsel (fund company), 364
SCM Universe Bond Total Return Index (Canadian index), 388
Scotia Capital Markets (Canadian index), 330–331, 388
Scotiabank, 301
ScotiaMcLeod Direct Investing (broker), 424, 430
screening, investment, 459–463, 467–473
secondary market, 311, 455
sector fund, 319, 392, 515
secured loan, 71, 73, 730
Securities and Exchange Commission (SEC), 398

securities commission, 398–399, 425
Sedar.com (Web site), 310
seed capital, 666–669
segregated fund, 358, 393
self-employment. *See* business ownership
self-regulatory organization (SRO), 425, 426
seller, of home, 202
seller fee, 184
seller property information sheet (SPIS), 257
selling a home. *See* home sale
septic inspection, 212
share
  business loan collateral, 664
  business ownership after death, 614–615
  defined, 305, 374
  employer's purchase plan, 526
  estate freeze, 578
  estate planning, 607
  example will, 629
  good versus bad market, 375
  mutual funds, 316
  P/E ratio, 310, 418
shareholder
  annual/quarterly reports, 310
  business ownership after death, 607, 614–615
  defined, 305
  rights, 400
shareholders' agreement, 614, 615
shares outstanding, 471
shopping. *See* spending money
short sale, 443–446
short-term bond, 388, 454
short-term goal, 25, 87, 405–406
signature, contract, 207
signing provision, 630–631
simple interest, 662
small-cap stock, 402, 404, 411
SmartMoney.com (Web site), 48, 462, 480
smoking, 103, 140
social insurance number, 136
software. *See* financial management software
sole proprietorship
  bank accounts, 709
  bankruptcy, 730
  estate planning, 606, 607–612
  tax liabilities, 695–698
source deduction, 491, 498–499
source document, 709, 713
S&P (Standard & Poor's) index (U.S. index), 331
specialty fund, 369, 392
specific power of attorney, 636–637
spending diary, 14–15, 80
spending money
  bartering alternatives, 51–52
  bulk shopping, 53
  coupons, 52–53
  credit card system, 66
  debt patterns, 79–80
  found money, 55
  hidden expenses, 115–117
  home equity loans, 101
  impulse spending, 22, 126–128
  low-cost entertainment, 53–54
  net worth calculation, 14–21
  prepurchase decision making, 39–41
  quality of life issues, 54–55
  rarely used items, 50–51
  shopping list, 55
  tax savings, 141
  tracking systems, 14–16, 49–50
SPIS (seller property information sheet), 257
splitting income, 141, 550
spouse
  beneficiary, 569–572, 588–591
  spousal rollover, 566–567
  spousal RRSP, 509–510, 531–533
S&P/TMX indexes (Canadian index), 329–330
SRO (self-regulatory organization), 425, 426
staging homes, 265
Standard & Poor's (S&P) index (U.S. index), 331
standard deduction, 139
standard deviation, 317
start-up company, 396–397, 651–654
statement of affairs, 109
statutory lien, 729
Stingy Investor (Web site), 351
stock
  analysis, 401–403, 467–473
  broker selection, 420–421, 425–427

stock *(continued)*
brokerage accounts, 430–432
business financing, 659
decision to sell, 334–336
defined, 305
described, 306–307
discount brokers, 347–351
diversification, 317, 337–338
dollar cost averaging, 339
eager purchase, 413
employer's company, 526–527
financial goals, 403–407
full-service versus discount brokers, 421–424
investment purpose, 407–409
issuance, 396–398
market analysis, 309–311
online investment services, 427–430
online screening, 467–473
performance measures, 328–333
personality types, 404, 410–411
risks and rewards, 291–293
RRSP options, 517–518, 520
salespeople, 357–363
shareholder rights, 400
tables, 414–419
tax implications, 341
types of, 307–309
stock market
balanced fund performance, 382
basic investing theory, 374–375
condition-related orders, 436
described, 306, 396
indices, 329–333
performance measures, 328–333
popularity of investing, 395
real estate investment trusts, 324–325
regulations, 398–399, 425
retirement considerations, 536
short sales, 446
stock trade. *See* trading stock
stockbroker. *See* broker, investment
stop order, 436–437, 445
strata obligation, 185
Strategis (Web site), 658
strip bond, 313, 453–454, 456
structural damage, 259
student loan, 139
subject to clauses condition, 203–205, 272–282, 287
subject property, 202–203
subject to removal document, 273
subject-to-sale condition, 226–228
sub-prime mortgage, 101, 106, 166
subsidiary underwriter, 397
Superintendent of Bankruptcy, 108, 109
supplier credit, 664–665
supply/demand principle, 306
survey, property, 184, 204, 215–217, 235
Symbol column, of stock table, 416

• T •

target market, 679–682
TATV (Web site), 195
tax. *See also specific types*
advantages of home ownership, 323
audits, 142–144, 700–701
bond analysis, 315
budget worksheet, 93
charitable donations, 46
credit card costs, 67
debt-reduction plan, 102
expense categories, 73
filing dates, 697, 698
GIC maturity, 328
government bonds, 313
guaranteed investment certificates, 303
hidden expenses, 116
home purchase legalities, 184
information publications, 73
monthly budget, 124
net worth calculation, 10–11
payment concerns, 73
planning strategies, 137–140
preparers, 144
real estate investors, 324, 325
RRSP advantages, 46
savings strategies, 46
tax-cutting tips, 140–142
terminal return, 568, 571, 594
total debt obligation, 76–79
tax-free savings account (TFSA), 340
T-bill. *See* treasury bill

TD Waterhouse Private Investment Advice (broker), 421, 424, 430
teamwork, 128–129
telephone industry, 377
tenancy in common, 202
term insurance, 542
terminal return, 568, 571, 594
termite warranty, 236
testamentary guardian, 602–604
testator, 618
TFSA (tax-free savings account), 340
third-party subject clause, 276–277
Thomson Investors Network (screening tool), 463
tiered account, 301, 304, 327
time clause, 227, 275–276, 282
time management, 27–28
time-related order, 434–435
title, property, 184, 254, 285
tobacco tax, 140
Tokyo Stock Exchange, 306
Toronto, 244
Toronto Stock Exchange (TSX/TMX), 306, 320, 329
trading stock
  closing and dividend dates, 419
  diversification, 369–370
  mutual fund guidelines, 366–369
  online brokers, 427–430
  orders, 433–440
  short sale, 443–446
  stock analysis, 403
  stock on margin, 440–443
  volume reports, 416–417
trailing stop, 437–438
transaction charge, 67, 301
Transamerica Life (annuity company), 545
travelzoo.com (Web site), 54
treasury bill (T-bill)
  average return, 293
  described, 312, 476
  money market fund selection, 391
  purchase between investments, 335
  purchasing process, 482
  RRSP options, 517
  selling process, 482–483
TreasuryDirect (Web site), 482–483
trust
  beneficiary provisions, 588
  charitable donations, 580
  described, 559
  estate freeze, 577–578
  executor functions, 594
  home-buyer's deposit, 272
  will example, 623, 627–628
trustee
  bankruptcy proceedings, 108–109, 731
  defined, 559
  estate freeze, 577–578
  as executor, 595
TSX/TMX (Toronto Stock Exchange), 306, 320, 329
turnover, portfolio, 322

• U •

ultra-cap stock, 402
underwriter, 397, 398
unit, 316, 390
United States
  employment in, 512
  money market funds, 391
  mutual funds, 460
  savings bonds, 481–482
Universe Bond Index (Canadian index), 330–331
unsecured loan, 71, 73, 729
uptick rule, 446
utility disclosure, 258
utility expense
  budget worksheet, 93
  hidden expenses, 116
  home ownership costs, 150, 151
  home sale, 234, 262
  taxes, 140

• V •

value fund, 319
Value Line (investment publication), 309–310
value stock, 308–309, 468
Vancouver, 244
variable rate mortgage
  versus fixed rate mortgage, 158–160, 162
  mortgage crisis, 166
  questions for broker, 172
V-Day (capital gains cutoff), 566
vendor take back (VTB) mortgage, 164
ventilation, 213, 259
venture capital, 668–669
venture fund, 318
volatility, 307, 439
volume, trading, 416–417

• W •

Wall Street Journal (newspaper), 414
wants, personal, 37–41
warranty, 118, 210, 217–219, 236
wealth-management advisor, 359–360
whole-life insurance, 542
will
  beneficiary provisions, 588
  charitable donations, 579
  described, 558–559
  elements of, 622–631
  estate tax bill, 583
  estate-planning benefits, 557
  example of, 619–621
  intestate death, 617
  record keeping, 136
  standard pattern, 618
  updates, 618
Wilshire 5000 index (U.S. index), 332–333
world fund, 319
wrap account, 359

• Y •

Yahoo! Finance (Web site), 439, 472
yield. *See also* return on investment
  bond valuation process, 477–480
  defined, 418
  dividend calculations, 408–409
  stock screens, 470–471
  stock tables, 418
yield to maturity (YTM), 315, 479–480
young investor, 489, 495, 515

• Z •

Zacks (Web site), 473
zero down mortgage, 165–166
zero-coupon bond, 313, 453, 477