

Avoiding Financial Disaster

Here are some tips to help you avoid some of the common financial pitfalls of divorce.

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Many couples face financial uncertainty after they divorce. This is often the result of using the same income to pay expenses to operate two households instead of one. For instance, you're now faced with two mortgage or rent payments; utilities, furniture, appliances, and supplies for two homes...The expenses add up.

If only one ex-spouse works outside of the home, then he or she may have to pay both spousal and child support, which will negatively affect the payor's cash flow. If both spouses work outside of the home, then each would have only a portion of their combined income to use to pay for their individual household expenses.

Separation or divorce is a time when both of you should reduce your spending and make an effort to live within your individual means. For instance, if you're not working, can you really afford the country-club dues or fresh flowers every week?

One common pitfall is considering the assets that you receive as part of the property settlement as an additional source of income. Instead of using these assets to pay for current expenses, they should be maintained for emergencies, retirement, creating new sources of income, and other long-term financial goals.

This does not mean that you should never touch these assets: it's one thing to use them to pay for tuition to improve your job skills, but quite another to deplete them to purchase a brand-new SUV. Before you dip into these assets, ask yourself whether the expenditure is going to create income for you in the future, or whether it's a frivolous purchase you're going to regret when the bill comes due.

Let's take a look at an example of how failing to create and stick to a realistic budget post-divorce could affect your future.

The Grasshopper and the Ant, Post-Divorce

Consider the cases of Lisa and Teri: two sisters who married men with very different careers. Lisa's husband became a wealthy stockbroker, while Teri's husband worked at the local GM plant. Eventually, both couples divorced.

Lisa was awarded five years of alimony at \$75,000 per year, half of her husband's retirement account (\$300,000), and the million-dollar family home. Lisa was not used to living on a budget of \$150,000 a year, and she wanted to preserve her image as a successful woman. For her, that meant country-club fees, \$25,000 a year on clothes, vacations in Palm Springs, lavish parties, summers in Europe, and keeping the family home. Her alimony did not come close to covering her expenses, but she dipped into her retirement account to cover the monthly shortfall. Five years later, she

Tips: Avoiding Financial Disaster

1. **Negotiate a reasonable settlement.** Get some professional advice from a CDFA or CFP to make sure you'll be able to live with the financial terms of the settlement -- now and into the future.
2. **Don't live beyond your income.** Reduce your expenses -- or increase your income -- so that you are always saving something for a rainy day. Ask your financial advisor for help creating a budget if necessary.
3. **Think twice about keeping the family home.** Ask your financial advisor whether you can truly afford it, and ask them to show you what cash you'd have available for investment if you moved to a smaller home.
4. **Realize that you won't get everything you want in the property division.** Don't spend months and thousands of dollars fighting over furniture, appliances, or other personal items. Make a short list of "Must-Haves" and be prepared to compromise on everything else. Look at the big picture; is this asset best for your situation?
5. **Protect your Retirement Assets.** In the U.S., have the QDRO filed as soon as possible. In Canada, make sure to have the pension valued by a qualified professional.
6. **Use debt sparingly.** Get a copy of your credit report and close all joint accounts and all credit you do not use. Avoid maintaining balances on credit cards.

has burned through her retirement savings, her support has ceased, and her only asset is the house that she cannot afford.

Teri, on the other hand, received \$20,000 per year in alimony for the same five years plus \$35,000 in retirement savings. She went back to school, which enabled her to get a better, full-time job before her support ended. She also put herself on a strict budget -- which included \$100 a month of "fun money" to spend on eating out, movies, or to save toward a bigger-ticket item such as an entertainment center or a vacation. Five years later, she has grown her retirement savings to \$100,000 and is enjoying the same lifestyle as before her divorce.

Lisa ended up with a better divorce settlement than Teri, but Teri is now in a much better position than her sister. Why? Aside from her obvious extravagances, Lisa's biggest mistakes include the facts that she:

- did not reduce her expenses, and she lived far above her means with no plans for ever bringing her expenses into line with her income;
- kept the family house instead of buying a smaller place and investing the difference;
- spent her retirement savings instead of investing it;
- did nothing to prepare herself for the day her alimony would end, such as going back to school or trying to turn one of her talents into a business: as a professional party-planner, for instance.

Not all Assets are Equal

When you are deciding on what assets you and your spouse will take, you should be aware that not all assets are equal. One of you may end up with a huge tax bill when you access the assets: for instance, you could end up paying capital-gain taxes upon the sale of your home or your investment assets. In addition, if you dip into your retirement assets, you may end up paying income tax and a penalty. In the example above, Lisa paid taxes and a 10% penalty in the U.S. every year that she dipped into the retirement account.

Other assets may end up being a money pit. Your primary residence, vacation home, or rental properties could cost you a significant amount of money to maintain. Frequently, the primary benefit of a rental property is not necessarily cash flow, but the tax losses that are generated. If you are in a low tax bracket, then these losses may not benefit you to the extent that another investment would. Your expenses may actually increase. For example, if your spouse used to make all repairs, mow the lawn, etc., but now you have to hire someone to do those things, then your expenses will increase. Would you be better off liquidating these properties and investing the proceeds in something that would increase your cash flow instead of creating a financial drain?

The Family Home

Reducing expenses may mean selling the family home and downsizing to a smaller home. In the example above, did Lisa really need the million-dollar family home? In this case, "keeping up appearances" cost her a comfortable future. If she had sold the house at the time of her divorce, she could have increased her cash flow in two ways: decreased costs, and additional funds to invest. The costs to maintain her home -- such as property taxes, utilities, maintenance, and repairs -- would have decreased in a well-maintained but more modest property. In addition, since there was no mortgage on her home, she would have been able to buy a smaller home free and clear and still have funds left over to invest and increase her cash flow.

Her choice to keep the house also meant that she was hit with all the capital-gains tax from the time she and her ex-husband bought the house in 1975 to the time she was forced to sell it. The house had appreciated significantly in value over the years, so after paying her tax bill, she was left with a much smaller nest egg than she had expected to help her start over.

Choose Your Battles

You can go broke during property division if you insist on fighting over every last item. During her marriage, Mary purchased a leather desk-accessories set that included a matching leather wastepaper basket. Her husband Larry wanted the wastepaper basket, but she insisted that the set would be incomplete without it, so they ended up fighting over it. After spending in excess of \$5,000 in attorney's fees, Mary ended up with

the wastepaper basket. Does this sound too ridiculous to be true? Be warned: this kind of thing happens every day in divorce court. Emotions are running high, and some people will fight "to the death" over truly trivial items. Sometimes, they're more concerned with making sure their ex-spouse doesn't get something than with actually getting it themselves.

You have to look at the big picture. Is this item really worth fighting over? Can you purchase a new one for significantly less than you will spend in attorney's fees? Not only are you wasting money, but you are also increasing the ill-will between you and your soon-to-be ex. If you have children, this can take an emotional toll on them.

Here's a hard truth for you: no one gets everything they want in a divorce settlement. You will have to give up some possessions you really like -- maybe even some heirlooms -- so prepare for this by creating a short list of "Must-Haves," a longer list of "Would-Like-to-Haves," and a third list of "Don't-Wants." Don't tell your ex you don't want the items on this third list; instead, "gracefully" offer to trade them for the items you really want. Be prepared to give up some of your "Would-Like-to-Haves" in exchange for more of your "Must-Haves."

Forgettable assets

Some assets are easy to forget, such as pensions, stock options from an employer, accrued sick and vacation pay, the cash value of insurance policies, frequent-flyer miles, prepaid dues (such as annual country-club dues and season's tickets or passes), and timeshare properties and vacation clubs. These should be addressed as part of the property settlement. In many cases, pensions can be worth more than houses, so make sure you have a qualified financial professional value these and other assets before you sign away your rights to them.

Credit Rating and Debt

It is imperative to protect your credit rating. Here are some tips:

- get a copy of your credit report
- close all accounts that you do not use
- if you don't already have one, apply for a credit card in your name only
- close all joint accounts and credit cards.

A vindictive or spendthrift ex-spouse can incur debt on your joint accounts and destroy your credit rating during the divorce process. If you're not able to pay off a joint account in full, ask if you can maintain a balance on it after it's been closed.

Your credit report will help you discover any outstanding debts that need to be addressed as part of the divorce process. It may be best to pay off joint debts with marital assets, and then each spouse can move forward with a clean slate.

Once your divorce is final, you should use your credit cards sparingly. If you need to establish a credit rating, make sure to pay off all balances on time every month.

If you need to use credit for short-term liquidity, then you may be better off refinancing your home and avoiding maintaining a balance on your credit cards. The benefits of refinancing your home include deductibility of interest and a lower interest rate. You will need to qualify for the mortgage, but spousal and child support are generally included as sources of income to permit a non-working spouse to qualify for a mortgage.

Back to Work or School?

You may have to go back to work to supplement your support payments. If you don't go back to work now, do you want to wear a fast-food restaurant uniform when you're in your 60s or 70s? Your property settlement

assets should be kept for your retirement -- remember Lisa's example (above) when you're tempted to dip into your retirement account.

You have to be realistic about any career changes you make. What are your prospects at your current job? If you go back to school, what can you realistically expect to earn? Will your degree improve your earning capacity? Are you taking courses that will help you secure a position in a growth industry that needs qualified workers, or are you just taking a course because it interests you? Does your chosen career or course of study take advantage of your natural strengths, abilities, and interests? Taking courses you hate to secure a job you'll hate is not a wise use of time or money. Work with a career counselor or personal coach to figure out the pros and cons of staying put or changing direction.

The Bottom Line

Your lifestyle will change after your divorce. You will have to make some sacrifices. However, if you plan ahead, these sacrifices will pale beside how bright and prosperous your future will be.

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