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# Safe Harbor: A Financially Secure Future

Here's help navigating the dangerous waters of divorce so you'll reach safe harbor: a financially sound future.

By Diana Shepherd, CDFA™

While you were married, you and your spouse were both co-owners of the "business" called your marriage. Like any business owners, you accumulated both assets and liabilities. Maybe you bought a house, a car, a cottage, some furniture. One or both of you earned income, maybe put some money aside for retirement. In addition to mortgage and car loans, you might also have accumulated some credit-card debt. Maybe one or both of you had a bad year — you got sick, or your spouse was laid off — and your financial troubles were the final straw in an already troubled relationship.

Whatever your own reasons were for ending your marriage, money is going to play a big part in your divorce process. Since property division on divorce is a state or provincial matter, there are regional differences when it comes to dividing the marital pie. You'll need to ask your lawyer about the rules governing property division in your area, but here are some general rules to get you started.

**Marital vs. Separate Property**

The first thing to know is that there are two kinds of property: Marital and Separate. Anything that is marital will go into the marital pie that's going to be divided; anything that's separate property will not. The distinction between the two is a gray area and should be discussed with your lawyer, but here's how most courts typically define separate property.

Separate property is anything that was gifted during the marriage, inherited during the marriage, or brought into the marriage and kept in either spouse's separate name. Everything that's not considered separate property is considered marital — no matter whose name it's in. Let's take a look at some examples.

Eight years ago, Susan's Aunt Virginia passed away and left Susan $150,000 in her Will. Susan placed the money in a bank account in her separate name, which means that the money she inherited is her separate property and not up for division now that she's getting divorced. But what if Susan had taken her $150,000 inheritance and used it to pay off the mortgage on the marital home? She could ask her lawyer to try to subtract $150,000 from the marital portion, but the courts are likely to rule that the inheritance became marital property when she invested it in the home. As a general rule, separate property can become marital property if it is "commingled" (e.g., if Susan had put the inheritance into a joint account with her husband Bill rather than one in her name only), or by making a "presumptive gift to the marriage" (e.g., using the inheritance money to renovate the kitchen, or to take the family on vacation, or to buy a motor-boat that the family all enjoyed at the cottage).

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So if Susan kept her inheritance completely separate, it remains her separate property. But what about the interest the original inheritance earned — is that her separate property, too? Probably not: any increase in value on the inheritance (or any other separate property) is considered marital in most areas. So if that original $150,000 had grown to $175,000 at the time of her divorce, the $25,000 in growth might be considered marital, depending on local law.

When Sara and Frank got married 10 years ago, Frank moved into the house Sara had inherited from her parents. She was in love, so she told her husband Frank: "What's mine is yours and what's yours is mine." So she changed the title on her house from her name alone to both of their names. Even if Frank husband never contributed a dime to the upkeep or maintenance of the house, in most areas, the house will likely be part the marital pie and up for division now that they're getting divorced. In some areas, the marital home is treated differently than other assets; even though Sara owned the house before she got married, the mere fact of Frank's moving in would have turned the home into a marital asset — whether or not Sara had put his name on the title. This is not true in all states and provinces, so make sure to ask your lawyer about how the marital home is treated in your area.

Let's look at one more example. Don was the saver in the family, and during his marriage to Joan, he automatically deducted $100 from each paycheck and placed it in a high-interest account in his separate name. Do you think the money in that account is marital or separate property? It's marital, because everything Don earned during his marriage is marital property regardless of whose name is on the account.

The general rule is that everything that either of you earned, purchased, or saved during your marriage is marital property, which must be divided with your spouse when you divorce.

**The Marital Home**

In many divorces, one of the biggest questions is what to do with the marital home. Should the wife get it, should the husband, or should they sell it and split the proceeds? What if the house is "underwater" — meaning that the householders owe more on their mortgages than their houses are worth?

In a normal economy, couples typically build equity in their homes; if they decide to divorce, they would usually divide the equity they had built by sell-ing the house or by one partner buying out the other's share. But these days (due to economic factors beyond divorcing people's control), many couples own houses that neither spouse can afford to maintain on his/her own, and that they cannot sell for what they owe. With the housing market still struggling in many areas, what used to be one of a couple's biggest assets has turned into a liability.

Before the recession, there were generally two main options for the home:

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1. One spouse stays in the house (with the children, if any) and buys the other spouse's share.
2. The spouses sell the house during or after the divorce process and split the proceeds.

Now, let's look at today's reality.

In a recent survey of Certified Divorce Financial Analyst™ (CDFA™) professionals across the U.S. and Canada, 67% of respondents stated that the current housing market has forced them to come up with creative solutions to property-division problems when the matrimonial home fails to sell — or would sell for less than what clients still owe on the mortgage. The most common solution is for ex-spouses to retain joint ownership and continue to live in the house (often, he moves into the basement and she lives upstairs) until the market improves, agreeing to postpone final division of assets until after the house is sold. Other common solutions include:

1. Renting the house to a third party until the house can sell for more than the debt.
2. One ex-spouse stays in the house until the market improves.
3. "Birdnesting". The ex-spouses retain joint ownership of the home, they rent a small apartment nearby, and each one alternates living in the house with the kids and in the apartment on his/her own.
4. One ex-spouse stays in the house and pays rent to the other until the market improves.
5. Structure two levels of spousal support: before and after the house sells.
6. Agree to sell the home at a loss, share the loss, and move on with their lives.
7. Short-sale, foreclosure, or bankruptcy.

If you and your spouse have agreed to continue to own the house together for a period of time post-divorce — for instance, until your children reach a certain age, or until the market recovers and they can at least break-even on the sale of your home — but only one of you is going to continue to live in the home, then you'll have to negotiate who pays for what until the house is sold. In many cases, the person who remains in the home pays the mortgage and taxes and may get some credit for any reduction in principal on the mortgage from the date of the divorce until the date that the home is sold. If the mortgage payment is similar to what the other person has to pay in rent, then they might agree that the person who stays in the home gets no credit for reducing the principal since he/she is enjoying the benefits of living in the home. Major repairs are usually divided between the parties — either at the time of the repair, or by reimbursing the person who has paid for the repair over time or when the house is sold.

**Hopelessly Devoted**

Sometimes, people — mostly women, in this case — are determined to stay in the marital home no matter what. It's the place where their children were born; they decorated it with loving care over the years; it represents security and familiarity in the rapidly-shifting landscape of divorce. In some cases, keeping the home can be a big mistake — a mistake that could lead to financial ruin. We've seen people willing to give up their share in their spouse's pension, joint investments, or savings accounts in order to keep the house. But if you can't afford to cover the mortgage, taxes, repairs, and maintenance on your own — without dipping into your savings or retirement accounts — then keeping the home may be a decision you'll come to regret. Talk to your CDFA™ professional about what your financial future will look like if you keep or if you sell the home before making your final decision.

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**Create a Budget**

It is absolutely crucial to develop a realistic post-divorce budget so you'll know what you need — and whether the property division and spousal or child support payments (if any) will cover these needs. To do this, you'll need to determine the income and expense for both you and your spouse and also try to estimate what both of your expenses will be after the divorce is final. This is a difficult task for many people — especially if you were not the spouse who handled the family finances while you were married. A CDFA™ professional can help you to develop a budget and figure out your cash-flow needs — and also let you know if you're steering towards financial security or disaster. Working with a CDFA™ pro allows you to see both the short-term and long-term financial effects of accepting "Settlement A" vs. "Settlement B", which will help you to make better financial decisions at a difficult time.

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