Should you use your inheritance to pay down debt?

If you're set to receive an inheritance in the next few years, you have a big choice to make: how should you use it?

Canada is entering the country's largest-ever transfer of wealth: over the next decade, baby boomers are set to inherit an estimated $750 billion.

There are just over 2.5 million people over the age of 75 in the country, and they're also the wealthiest cohort of Canadians. In the next 10 years, they're expected to hand over large sums to their families, according to a CIBC Capital Markets report.

The average inheritance is about $180,000, and 66 per cent of it is in liquid cash.

"Inheritances are becoming very common as people are aging," says Mike Gomes, a Toronto-based certified financial planner at Ironshield. The windfall helps people cover the later years of their life or, if they're carrying debt, it bails them out, he says.

Coincidentally, baby boomers carry about $180,000 in debt, according a recent Manulife Bank Homeowner Debt Survey. Their kids - Gen Xers and millennials - carry even more. Additionally, 17 per cent of baby boomers were "caught short" paying bills over the last 12 months, making it tempting to put a large inheritance toward paying off bills.

However, whether you're getting an inheritance or a windfall from somewhere else, "you need to be wise with what you do with it and never count on it in your budgeting and savings goals," says Pat White, executive director of Credit Counselling Canada.

If you have multiple priorities to attack and a $180,000 windfall coming your way, what is the wisest decision to make with your inheritance?

Consider the intentions of your relative.
In some cases, the guidelines on the inheritance are explicit. Your parents or grandparents may have outlined specific uses for the money in their will, and there may even be something in place to make sure you can't touch the money for any other reason.

Often, though, there are no instructions left behind, says Gomes.

"It's up to the person passing away and respecting their wishes, but if there's nothing in the will, typically nothing's discussed," he says.

In that case, here are some steps you can take to make sure the inheritance is used responsibly:

1. **Pay off high-interest debts first.**
   It makes most sense to apply your newfound cash toward your highest-interest debts -- usually, that's credit card debt and lines of credit, says Gomes.

   With high-interest debts out of the way, you can work on paying down your lower-interest balances with a little bit of breathing room.

2. **Invest or pay low-interest debts.**
   Only 40 per cent of Canadians put their inheritances toward savings or investments - the majority used it for daily expenses, according to CIBC.

   "Lower- and middle-income Canadians will use their inheritance for expenses, credit and debt and replenishing an emergency savings fund if they don't have one," White says. "And those are good uses."

   With high-interest debt paid off (or nonexistent), you'll have to consider what's best for you: paying off low-interest debt or investing in your future retirement.

   "$180,000 is not a lot when it comes to retirement," White says. But you don't want to outlive your money, and a few hundred thousand dollars could help cushion your golden years.

   "If I got something from a relative now, I'd look at my own retirement first," White says.

   Gomes agrees. "Your mortgage could have an interest rate of 2.2 per cent, but you could be investing earning 5 per cent," he says.

3. **Help loved ones - after you're financially set.**
   Your instinct may be to look after other people's debts, White says, but you should look at your own bottom line first.

   She says her agency has seen many baby boomers indebted because they took out second mortgages or loans to help their kids buy homes or pay off debts. In the end, the parents end up leaning on their kids to help them.

   After you've helped yourself, you can start helping your loved ones.

   "It sounds selfish, but it's necessary," Gomes says. "It's tough to gift freely before figuring out the unknowns."

   It may be better to offer to patch a down payment or contribute $1 for every $5 your kids pay off on student loans. You can also dole out financial help as an annuity, so that smaller sums are given out each year instead of a lump sum.

Get professional financial advice.
Whatever you decide to do with your inheritance, don't make big financial decisions on your own. If you're in debt and you're using the cash to pay off debts, a credit counsellor can help to make sure you don't return to old habits. You won't have a second inheritance to bail you out again.

A certified financial planner is also at the ready to help pave the way to ensuring you have enough money tucked away to cover your retirement, or make the most of your inheritance to strategically pay off debts.

Don't count on an inheritance.
Both White and Gomes caution against relying on an inheritance to cover debts or to fund retirement, for your or your loved ones.

"While some may inherit a lot of money, others may not at all, and others won't get it until late into retirement," White says.

"Put it out of your mind and have conversations with your kids so they know not to expect anything either," she says.

An inheritance, like any windfall, can seem like the answer to your problems. However, the best plan is to be proactive and work hard now. Then, by the time you're ready to receive an inheritance, you can put the funds in your growing retirement account or toward other fun, rather than using it all to pay down the debt you accrued along the way (leaving nothing for your own kids).