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More people are counting on home equity to shelter them from a retirement crunch

By [Jade Hemeon](#)

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With the canadian residential housing market gaining 10% a year, on average, since 2002, it's common for financial advisors to hear their clients talk about retiring wealthy from the sale of their homes. Granted, the family home can make a valuable contribution to a well-diversified portfolio of assets, but counting on the house alone to provide for what is becoming a longer and healthier retirement is not necessarily a wise strategy.

And with the real estate market getting long in the tooth in Canada and showing signs of serious decay in the U.S., the strategy of selling a house or investment property profitably at the drop of hat may be difficult to execute.

"The family home can be a realistic source of capital, but there is the big question of replacement and where the owners will live next," says Warren Baldwin, regional vice president of Toronto-based **T.E. Financial Consultants Ltd.** "A park bench is not so enticing. Unless clients are prepared to make a downward lifestyle adjustment, I wouldn't be so quick to view a home as retirement security."

Yet research done earlier this year by **Royal Bank of Canada** found that 90% of Canadians surveyed — the highest level since 1998 — view buying a home as a good investment. And almost one in five homeowners expects their home will be a primary source of retirement income.

That is not altogether surprising. Accord-ing to Dave Richardson, vice president of **RBC Asset Management Inc.** in Toronto, expectations for future growth — be it houses, tech stocks or energy stocks — tend to be highest after a period of unusually rapid price appreciation, such as has

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happened in the housing market during the past five years.

“Most people have the bulk of their net worth tied up in their houses,” he says. “As their homes increase in value along with their need for retirement income, the house can certainly be viewed as one of a handful of ways to finance retirement. But it depends on a client’s willingness to sell or downsize his or her home. And the house should be viewed as only one potential source of income, along with pensions, RRSPs and other investments.”

But the good thing about owning a home is that it encourages the kind of long-term commitment that would serve investors well in other investment endeavours, Richardson says. Most people live in their homes for a significant period of time rather than trading in and out. And the fact that a principal residence can be sold with no capital gains taxes on the profits can significantly enhance the accumulation of wealth.

“If the real estate market falls, people don’t rush out and sell their homes — as they often do when stocks drop,” Richardson says. “Homeowners make regular mortgage payments and that becomes a form of forced savings. People don’t check the value every minute, and there’s a discipline involved in paying off a property.”

However, a rapidly rising market and availability of mortgages requiring little or even no down payment has encouraged many people to get heavily into debt to finance their participation in the real estate market. If there is minimal or no equity in a home, the owner is extremely vulnerable to a drop in real estate values that could make a mortgage difficult to renew, or to an increase in interest rates that could make it too expensive to carry. According to Royal Bank’s research, 60% of Canadian homeowners currently have a mortgage, and one-third of those aged 55 or more have a mortgage. Almost half of Canadians think they will carry their mortgage into retirement.

“The bull market in real estate has encouraged some people to trade up to the highest level of house they can afford and leverage to the max,” says Tina Tehranchian, a certified financial planner and the branch manager for **Assante Capital Management Ltd.** in Richmond Hill, Ont. “I encourage clients to calculate their ability to manage their cash flow and carry their house if interest rates were to increase by three percentage points. No one wants to be forced to sell.”

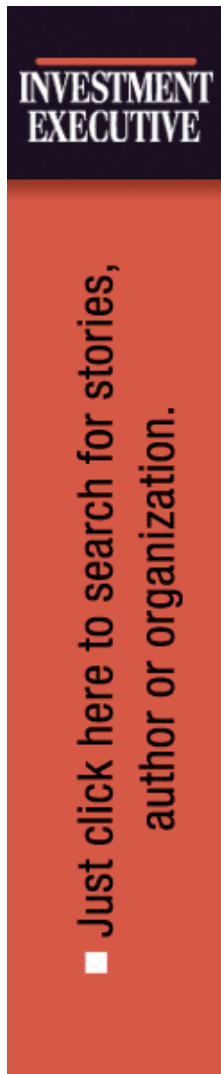
Leveraging up is risky. But it is not the only risk homeowners face. Because a house is such a large purchase, it often accounts for a disproportionate share of client assets — and that is where the risk lies, says Moshe Milevsky, professor of finance at York University in Toronto.

“If you could buy a bathroom in Halifax and a bedroom in Alberta, then you could be better diversified, but having a house is like owning just one stock,” Milevsky says. “In addition, there are enormous hidden costs and expenses that can eat up the annual appreciation. If you own a house, you should remain as true as possible to the principle of diversification, and lighten up on other forms of real estate investments in your RRSP, including stocks in real estate companies and real estate investment trusts.”

Milevsky thinks investors should have at least 25% equity in their homes to protect against any potential deflation in prices.

Of course, homeowners counting their wealth expect housing prices to continue. And they may be right. Although the U.S. housing market is showing signs of sagging, with unit sales slowing and prices flattening, the Canadian market continues to be healthy. **Canada Mortgage and Housing Corp.** estimates that prices for existing homes will increase by 12% on a national basis in 2006, the best increase since 1989, with particularly strong growth in Alberta and British Columbia. The CMHC predicts that the rate of price increases will moderate to 6.4% in 2007, as some overheated parts of the country move toward more balanced conditions and the number of units sold decreases slightly across the country. But the CMHC is not predicting a U.S.-style retreat. The month of July had a 4.1% drop in the number of Canadian homes sold relative to a year earlier, but the average national resale price jumped by 11.5%, according to the Canadian Real Estate Association.

“The pace of growth in the Canadian market may slow somewhat, but I don’t expect a retraction in prices,” says Phil Soper, president of Toronto-based **Royal LePage Real Estate Services Ltd.** “Like an RRSP, a home is one of the few tax-sheltered places you can put your money, and many Canadians continue to take advantage of that. From a financial-management standpoint, people who



buy homes early in their lives tend to be wealthier when they retire than otherwise, due to the tax-free accumulation of equity over a long time period.”

While the Canadian market may not continue to appreciate at the pace of the past several years, demographics indicate there should be strong growth in housing for many years to come, says David Foot, professor of economics at the University of Toronto and author of *Boom, Bust and Echo*. According to Foot, the major determinant of rising house prices is immigration, and he expects Canada will see increasing levels of new immigrants well into the second decade of this century.

“There is a perception that Canada needs workers, and current or higher levels of immigration will help maintain house prices,” Foot says. “They may not continue to increase rapidly, but there will be a floor.”

The CMHC forecasts immigration into Canada will increase by 8% to about 230,000 people in 2006, and by an additional 4.1% to 239,500 in 2007. Although the majority of newly arrived immigrants initially settle in rental accommodations, an increasing number move to home ownership as time passes. The top three destinations for new arrivals are expected to be Ontario, Quebec and B.C., with Alberta’s strong economy attracting a growing share of international immigration as well as drawing thousands of workers from other provinces. Employment and earnings growth are expected to be strongest in Alberta and B.C. over the next two years, with growth continuing at a slower pace in the rest of Canada.

Popular housing choices probably will shift as the baby boomers age. Foot believes many aging boomers will consider trading large suburban family homes for smaller dwellings such as condominiums. But many people will want to stay in familiar neighbourhoods, and be close to familiar social, recreational and cultural activities, as well as health support services and shopping.

According to a recent CMHC survey on aging, residential mobility and housing choices, the top reasons for Canadians in the 55- to 64-year-old age group to move include: the desire for a less expensive dwelling, for a better-quality dwelling or neighbourhood, and to be closer to facilities and services.

A large portion of seniors who move opt for condominiums because of security features and ease of maintenance. The older the person who is moving, the higher the likelihood a condominium will be selected. As people age, they find that climbing stairs becomes increasingly taxing or, in some cases, a dangerous risk for serious injury and hospitalization, says the CMHC. Even seniors who move to detached houses are showing a preference for homes with few stairs, and most seniors who choose detached houses go for houses with only one floor, such as bungalows.

“As people hit their 50s and 60s, they usually have reduced their mortgage to zero or close to it, and they have a significant financial asset [in] their home,” Foot says. “Moving to a condo is certainly a possibility, and many people will opt for a downtown location with access to attractions such as the opera, symphony and library. Some of these condo owners may have another residence somewhere else, and the opportunity to sell one down the road in their mid-70s could provide a significant financial shot in the arm at a later stage.”

For people who live in a big city, he says, a successful downsizing strategy could be to move to a smaller community in which prices are lower, such as moving from Toronto to Guelph, Ont., or from Vancouver to Kelowna, B.C.

“Smaller communities can be nice places to live, and changing communities can be a way to generate capital from a house,” says Foot. “But people need to think through carefully where they want to live, and why.”

But moving may be easier said than done. Retirees who are counting on selling their houses and cashing in on the years of appreciation may find they are not ready and willing to move as soon as they thought they might be, says Bryan Snelson, a financial advisor with **Raymond James Ltd.** in Mississauga, Ont. Snelson, who says two-thirds of his clients are retired, finds that many have emotional ties to the family home and don’t want to move.

“The home is steeped in emotion and memories, and it’s easy when you’re young and detached to say you will sell it down the road. But many people have a hard time parting with the family homestead,”

Snelson says. "Often the whole family wants the parents to hang on, as the home is the centre of parties, celebrations and holidays."

In addition, many people who think they will be downsizing to a less expensive condo find that, after they choose a desirable location with good management and all the modern conveniences, the new two-bedroom condo could eat up just about all the proceeds from the sale of the sprawling suburban home. Even if a condo costs less up front, many people forget that condo service fees can run \$800 to \$1,000 a month.

"The amounts saved by reducing the mortgage may well be eaten up by monthly maintenance fees," Baldwin says. "Typically, people must trade down to a more modest lifestyle or move out of town to free up equity."

But, he adds, if people are truly willing to downsize and can trade down from a \$550,000 house to a \$350,000 house, for example, they can invest the proceeds in a diversified portfolio of financial assets offering growth or income. A smaller abode typically will have lower taxes and energy costs as well. For some, moving from a large home with a big yard to a townhouse a realistic compromise.

"With my children at university, I had a lot of empty space in my five-bedroom house, and decided to move to an executive townhouse to free up capital," says Patricia Lovett-Reid, senior vice president at **TD Waterhouse Canada Inc.** in Toronto. "The great debate is that you have to live somewhere. But if you're living in a home that is eating up too much of your income, then your assets are controlling your life."

Some clients who hold houses that have increased in value over the years may want to consider other options for taking advantage of the buildup of equity besides selling. There are various ways to borrow against the equity in a home and, for some clients, a reverse mortgage or a line of credit makes sense. The cash proceeds can be invested in annuities or investments to provide income. However, there is often emotional resistance to saddling a house with new debt when a client has spent years paying off a mortgage, and some retirees are concerned about eating into their children's inheritance.

Alternatively, refinancing a house can be a strategy for renovating and increasing the value of a home, or providing the leverage to purchase a second residence, such as condo or a recreational property. There are risks with this strategy, particularly if the client is buying the property for quick resale rather than for personal use over the years. Additional properties can also lead to even more exposure to real estate, further reducing diversification of assets.

If the plan is to purchase a condo and rent it out for a few years until it is needed by the owner, the client needs to keep in mind that a lot of potential renters have bought their own condos during the past few years so it may be difficult to earn rental income. And not everyone enjoys landlord responsibilities, such as fixing broken toilets, dealing with bad tenants and covering costs when the unit is vacant. In addition, the building's management and tenants may change over the years, and there is less control over maintenance costs than with a traditional home.

"People need to think through the risks and worst-case scenarios," says Foot. "They may be buying the latest thing today, but 10 or 15 years from now, there may be other things that are more up-to-date and attractive, and the property could look a little tired."

Instead of leveraging up to more real estate, Diane McCurdy, president of Vancouver-based **McCurdy Financial Planning Inc.**, advocates paying down a mortgage and getting rid of debt, then using all or a portion of the money that would have gone toward a monthly mortgage payment to make regular monthly investments in a diversified financial portfolio. If a client wants to buy a recreational property such as a ski chalet at Whistler, she says, it should be a lifestyle decision rather than investment one.

"Property can be like art," she says. "If it turns into money, it's a bonus, But you may be living with it for a long time." **IE**

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