OPINION

Poor millionaire homeowners: Retirement with lots of home equity and not enough savings

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When you celebrate real estate like we do in Canada, you end up with anomalies such as people who are house rich and retirement poor.

It all starts when you stretch your finances to buy a house and justify it with the expectation of building wealth through home equity. A preview of how this might work can be found in retired households with lots of equity but not enough income to cover living costs.

A reader of the Carrick on Money newsletter recently asked if seniors are eligible for the Guaranteed Income Supplement (GIS) if they live in a valuable home but have no other financial assets. The answer is yes – GIS eligibility is based on income and marital status, not assets.

Another query came from a reader with eightysomething parents who will deplete their retirement savings in two years but also own a paid-off house worth almost $1-million.

Could the parents get a mortgage of $300,000 and invest the money to generate income? Should they sell and rent?

These are the uncomfortable questions that get asked when people have most of their wealth trapped in a home. When you have money in a tax-free savings account, registered retirement savings plan or registered retirement income fund, it can easily be transferred into your chequing account in a couple of days, max. Home equity can substitute, but not easily or cheaply.

An extreme form of being rich in home equity with insufficient income is what the consultancy Open Policy refers to as "poor millionaire homeowners." Open Policy has found that Toronto's Top 50 neighbourhoods ranked by average home values in 2021 had 6,860 people 65 and older with poverty-level incomes and homes worth more than $1-million.

A more common story is the senior who starts off okay in retirement, then finds their savings are running out. One solution is selling the family home and renting, but this move requires some analysis of how much of the sale proceeds will be eaten up by rent. Decent accommodations can run as much as $3,000 a month or more.

People who want to stay in their home can access their equity to invest or spend, but they'll have to borrow against it using a home equity line of credit or a reverse mortgage. All of these options involve interest costs, which highlight the fact that you can't get free access to your home equity unless you sell. Otherwise, you basically have to rent it.

I asked lenders in my LinkedIn community about the availability of mortgages for this type of retiree, and the answers were not promising. Lenders have income requirements for mortgage applicants that may be difficult for retirees to meet, and home equity lines of credit can be similarly hard to arrange after retirement.

A basic rule if you're concerned about not having enough retirement income and own a home: Make sure you have a home equity line of credit (HELOC) in place before you leave the work force.

HELOCs aren't the cheap source of funds they were a few years ago – expect a borrowing cost of 5.45 per cent to 5.95 per cent. That's a fairly high hurdle to clear if you plan to invest your HELOC money to generate income.

Where HELOCs can help is in allowing you to instantly transfer money into your chequing account when needed, without having to disclose your personal business to anyone. You must pay the interest you owe every month, but repayment of the principal is generally left up to you.

Dipping endlessly into your HELOC to supplement your own savings, plus Canada Pension Plan benefits, Old Age Security and the GIS is unsustainable in the long term. You may eventually reach unaffordable levels of monthly interest-only payments and potentially run up against the borrowing limit on a HELOC. The general HELOC rule is that you can borrow as much as 65 per cent of your home's value.

I asked certified financial planner Rona Birenbaum about the eightysomething parents who are running out of money, and she replied in an e-mail that "their situation is exactly what reverse mortgages are designed for."

Reverse mortgage interest rates are high – they range from 6.6 per cent to almost 8 per cent. Borrowers can minimize interest costs by borrowing small amounts on a regular or as-needed basis rather than one lump sum.

Interest on a reverse mortgage accumulates in the background and then is paid along with the principal when you sell. If you keep the loan running for a long time, you could find disappointingly little home equity left.

The availability of reverse mortgages highlights the fact that being house-rich and retirement-poor is a fixable problem. But the fix demands compromises and trade-offs. If there's a lesson in all of this for today's house hunters, it's to buy a home that lets you afford to save for retirement.

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