FINANCIAL POST

If your retirement security is built on your home, now might be the time to sell

TED RECHTSHAFFEN | September 12, 2016 12:22 PM ET
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Chloe Cushman/National PostIf you are relying on something that many people say is 30% overvalued today, now might be the time to reduce or eliminate that big risk.

If you're a homeowner thinking about leaving work in the next few years, it may be time to cash in your lottery ticket (also known as your house) and trade it in for a comfortable retirement.

Across the country, but specifically in Vancouver and Toronto, the growth in house values has reached the point where, for many retiree homeowners, their house is by far their largest asset. It is not uncommon to see 75 per cent of someone's net worth tied up in their home.

As a certified financial planner those stats make me nervous - especially if the person in this situation is a retiree. Here are five reasons why:

1. Concentration risk. If an investment portfolio is too heavily weighted in one sector, we can see the risks. For example, if you owned 30 per cent or more in energy and materials in 2014 and 2015, you were hurt badly. Now, what do you say about someone who has more than half of their entire net worth in residential real estate on one street in one city? That is a very high level of concentration risk.

2. When house prices fall, recovery is very slow. In 1989 Toronto house prices dropped after a big rally. It took 13 years for prices to recover. When adjusted for inflation it took 20 years to recover! As a retiree, do you have 13 or 20 years to wait? The previous spike in Toronto took place in 1974. In that case it took 12 years to recover when adjusting for inflation. Predicting the fall of house prices has been a losing bet for several years, but when home prices start to fall, it can take many years to recover. You don't want to be forced to sell at a time when prices on your biggest asset are down.

3. Uncertainty. Most people want as much certainty as possible in their retirement and estate planning. If you want very low risk on an investment portfolio, it isn't that difficult to count on an average return of four per cent. The lower the risk, the lower the volatility. With house prices, you have no control. The value of your home could go up 10 per cent, go up five per cent or go down 10 per cent, and as a homeowner you simply ride the wave. If you want more certainty over your financial future, sell your house and put together a low risk portfolio.

4. Debt. This may not be an issue for some, but for those with debt on their home in retirement, there is an added risk. Today, the borrowing cost is very low, but IF housing markets turn down, it will likely be in part because borrowing costs have gone up. That combination of higher costs and lower equity can have a big impact on a retirement plan.

5. Maybe housing prices ARE overvalued. I am not in the real estate prediction game, but some pretty smart people (including economists with the OECD and IMF) are warning that real estate prices in Canada are overvalued by 30 per cent or more. In Vancouver, a house selling for $1.8 million today was selling for $1.2 million just two years ago. What if the house prices "crashed" to where they were just 24 months ago? That would take $600,000 out of your retirement nest egg. I know they have been saying it for a while, but at some point they will be right. If you are 45, then you might be OK riding out that storm and still selling at a great price in retirement. If you are 65 and thinking of downsizing anyway, that isn't a storm you want to weather.

Despite all of this, from a pure financial standpoint, I can think of one very good reason to stay fully invested in your home. The benefit is tax. There is almost nothing in Canada today that is as good a tax shelter as your principal residence. Remember that 100 per cent of the capital gains in your home are tax-free. Having said that, keep in mind that this large benefit is only of value on gains. There is no tax benefit to losing money on your principal residence, but cashing in a big capital gain tax-free certainly sounds pretty good.

So, if you are feeling concerned about having too many eggs in the real estate basket, what are your options?

1. Sell and rent: While many don't like the idea of renting after many years as an owner, from a financial perspective it can end up costing you very little when you subtract all of the real estate taxes and capital expenses that you regularly had to put into your house.

2. Sell and buy something much cheaper in the same city: This will allow you to cash out a good percentage of your lottery ticket while still owning property and benefiting from the tax advantages. One of the challenges with this one is that you will need to pay an extra set of real estate commissions, land transfer tax, etc.

3. Sell and buy less expensive property in a completely different location: This can be the move to cottage country, somewhere warmer or closer to grandchildren (as long as they don't live in Vancouver or Toronto).

When it comes to your home, there are lots of opinions floating around and nobody has the perfect answer. However, when it comes to your retirement, if you are relying on something that many people say is 30 per cent overvalued today, now might be the time to reduce or eliminate that big risk.

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References

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