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Fondation Canadienne pour la Planification Financière
Canadian Foundation for Financial Planning

Leveraging Equity in Residential Property to provide Retirement Income

Executive Summary

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Research conducted by:

University of Lethbridge

Introduction

An aging Canadian population, mounting pressure on pension systems, and recent growth in housing prices have sparked interest in using the equity stored in residential housing to supplement retirement income.

The FP Canada Research Foundation funded research conducted by Vishaal Baulkaran from University of Lethbridge and Pawan Jain from Virginia Commonwealth University, to investigate why, despite reported familiarity with Home Equity Release Schemes (HERS), only a small proportion of individuals benefit from them to pay for financial hardships or to fund a shortfall in retirement income.

The research examines why the use of home equity in retirement remains low despite the fact that the asset typically represents the largest component of household wealth for those entering retirement, and despite the growing demand on retirement assets to provide income for longer retirement periods. It examines not only the technical aspects of HERS but also the impact of behavioural biases influencing their use. In doing so, the research investigates the views of Canadians regarding accessing this wealth and the knowledge, attitude, and perspectives of Canadian financial planners towards recommending these arrangements.

Background

- The problem of not having sufficient capital to fund retirement income is not new but can be further exacerbated if a large portion of retirees' assets are tied to a personal residence.
- The report investigates the obstacles faced by cash-poor, asset-rich homeowners in accessing equity built up in their homes, including both technical and emotional barriers. It examines seven equity release options and how such strategies can supplement retirement income.
- The report includes an assessment of the impacts of behavioural bias on the consideration and implementation of leveraging home equity from both the consumer and financial planner perspectives.
- Traditional retirement planning generally ignores wealth stored in home equity and focuses primarily on the use of other financial assets. However, for many households, particularly those with less wealth, home equity represents a much larger asset than retirement savings accounts.

- 1,200 Canadian consumers were surveyed to construct a sample of individuals spanning retirement planning phases, including those who are working and should consider retirement planning, individuals who are mid-career, and those who are closer to retirement or retired. The average age of the sample group was 54.

  - Almost half of the consumer group (49%) reported that they currently have a financial planner.

- Financial planners from across Canada were surveyed and nearly 500 responses were received by financial planners holding either QAFP® or CFP® certification. The average number of years worked as a financial planner in the participant group is 18 years.

Key Findings

- Canadian homeowners are generally willing to access home equity when faced with financial hardships, such as paying for care, nursing, or support services.
- Having equity release products recommended by a financial planner makes them more attractive to consumers.
- Emotionally charged homeowners—coupled with the complexity and costs associated with equity release products—avoid tapping into their home equity to fund their retirements.
- Although financial planners report they are comfortable providing advice about using HERS, their preferred recommendation to meet a client's need for extra income during retirement is to sell investments.
- Financial planners' personal behavioral biases, and a lack of understanding and knowledge of the HERS products, can translate into lower adoption of these products by their clients.
- Education and improved knowledge would correct and, in certain cases, adjust for the behavioral biases of homeowners towards utilizing their home equity.

Equity release schemes allow homeowners to transform wealth stored in their principal residence into liquid assets, thus taking advantage of equity accumulated over the years. In the research paper, seven home equity release schemes are explored.

Reverse Mortgage – This strategy is arguably the most-marketed HERS in North America. A typical reverse mortgage is a mortgage loan secured by a residential property. Reverse mortgages allow homeowners to access their home equity while deferring payment of the loan until they die, sell, or move out of the home. Homeowners receive a pension-like payment with no required mortgage payments.

Home Equity Line of Credit (HELOC) – This option involves opening a revolving line of credit to borrow funds to a maximum of 65% of the appraised value of the home, using it as collateral. A HELOC is very flexible, and homeowners are allowed to make interest-only payments. Cash inflows are not taxable and do not impact OAS or GIS income tests.

Second Mortgage (non-HELOC) – Used in combination with a first mortgage, homeowners can borrow up to 80% of the appraised value of their home minus any outstanding balance in their first mortgage. Borrowers are required to make payments on the second mortgage while continuing to pay down their first mortgage. A second mortgage may not be a suitable equity release method for funding retirement income. However, it may be suitable to meet emergency expenses.

Refinancing the Home – A similar approach to a second mortgage, homeowners can borrow up to 80% of their home's appraised value minus the balance of any existing mortgage. Although not suitable for producing retirement income in many cases, it may be a suitable option for unexpected or emergency expenses.

Selling and moving to smaller owner-occupied home (Downsizing) – This may be the most straightforward way for homeowners to release housing equity. The option is relatively easy to understand and to implement and allows homeowners to access the difference between the equity stored in their house and the equity stored in the new house.

Selling and moving to a rental dwelling (Downsizing) – A different method of downsizing which involves selling a home and moving to a rental home, apartment, or other dwelling. The approach releases the total net equity in the homeowner's residence but may create less financial security over time.

Selling and renting it back (Sale and Lease Back) – An approach for the homeowner who wants to extract their housing equity without having to move. The homeowner sells their home to a third party then leases it back from the purchaser at commercial rates, typically in the form of a lifetime lease.

Want more information?

Additional materials on this topic
and other research projects are available
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Practice Notes

Research Paper

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