How to Use Your Home Equity to Keep Your Retirement Goals on Track

by Midori Hillis

After years of careful planning, saving and dreaming, you are almost there—close to retirement and ready to step out of the workforce and enjoy your time on your own terms. But wait; there's been a hiccup, a change in the plan that is causing you stress and anxiety. This can happen for a variety of reasons: a health event, a marriage breakdown, an unexpected large expense or simply a loss of motivation to continue working. Unforeseen circumstances can have a negative impact on your carefully crafted retirement plan, potentially even forcing you to postpone your retirement date or adjust the income level you can afford. How can you fill the gap and stay on track with your original plan?

Most Canadians will find significant value in their real estate, and you may find that a large portion of your own net worth is tied up in your home. In this chapter, we will review some options to help you accomplish your retirement objectives using your home and home equity, and we'll outline the different financial consequences.

Depending on the type of need you have, as well as your other financial circumstances, there are a variety of options to consider, including setting up a line of credit, using a reverse mortgage, creating rental income and downsizing. We will explore these now, as an overview, but before you commit to using your home as a resource you should consult with your trusted financial advisor. They can walk you through the benefits and pitfalls of each strategy and how it would relate to your own personal retirement and estate plans.

Setting Up a Line of Credit

The most common way to access home equity is through a home equity line of credit (HELOC), also known as a secured line of credit (SLOC). If this is something that works well for your situation, it is best to put it in place in advance of your retirement date, as the financial institution will want to confirm your income and debt levels and it's easier to qualify while you are still working.

Many pre-retirees create a home equity line of credit even if they don't need one right away, to have emergency funds available during retirement, if necessary. The nice thing is, if you don't carry a balance, you don't make any interest payments, you are just charged a nominal monthly account fee. Lines of credit are very flexible once set up, so you can access a lump sum or monthly income as needed.

Let's look at an example.

Debbie and John own a house mortgage-free and they both would like to retire in less than five years. The value of their home is $700,000 (the Canadian average in 2023). Generally, most financial institutions are willing to provide a credit line up to 50 to 65 percent of the value of the home; in this example, we will use 50 percent, or $350,000. Debbie has $25,000 in credit card debt and John needs to complete some house maintenance and repairs for around $50,000. They don't want to use their taxable RRSPs for these expenses, so accessing taxfree home equity seems like a good way for them to proceed, incurring a balance of $75,000 on their new line of credit.

This leaves $275,000 available room on the credit line, if needed, and a payment plan that Debbie and John control. While they are still working, they can make principal and interest payments to reduce the balance or simply pay only the interest. Minimum interest-only payments at 8 percent would be around $500 per month. (Interest rates on secured lines of credit are generally less than they are on unsecured lines of credit, consumer debt loans or credit cards.)

In addition to accessing a lump sum as needed, you might want to use the line of credit for increased cash flow to boost your retirement income or to retire sooner with your planned retirement cash flow. This can be accomplished by withdrawing a certain amount each month out of the line of credit.

Back to our example. With the renovations complete, Debbie and John have decided they want to stop working and retire earlier than planned, but they'll need an additional $1,000 per month to keep their income plans on target. Knowing that they will eventually have to downsize and move, they would like to stay in their home for the next five years. They already have a $75,000 outstanding balance on their HELOC and they plan to take another $12,000 per year for monthly income over the next five years, for a total of $60,000. Over that period, they end up paying around $45,000 in interest expenses, which they also cover with the credit line, growing it to a total balance of $180,000. This leaves them with approximately $520,000 in home equity, *plus* any increase in house value over the five years, to buy their next home.

Lines of credit can be an easy way to access home equity; the downside is that floating interest rates can create higher interest costs, and unchecked spending and reaching your credit limit may force you into an unfavourable situation. If that happens, you will need to make another decision to cover your line of credit debt: Do you sell and either buy a smaller place or rent, or do you set up a reverse mortgage?

What About a Reverse Mortgage?

Like a secured line of credit, a reverse mortgage gives you access to the equity in your home (principal residence only), generally capped at around 50 percent of market value, and any existing liens on your house would have to be paid off first. A reverse mortgage is a loan with a term, such as three to five years, available to homeowners who are at least 55 years old. This option can be very helpful if you want to stay in your home longer without affecting your cash flow. The main advantage is that there is no obligation to make payments during the term of the loan.

Interest rates are generally higher for a reverse mortgage than traditional mortgage rates. The terms of repayment are also stricter than line of credit terms, so I would suggest looking at this option only after you have considered and/or already used the line of credit solution. Sometimes a reverse mortgage is considered a "last resort" option, if nothing else can assist you.

That being said, I have seen reverse mortgages work wonders; they can be the right fit for those who want or need to stay in their home but can't afford to do so due to unforeseen family situations or health issues. Pre-retirees could use this option if they need to retire early to assist family members at home or if they themselves are unable to continue working. It would be a medium-term solution, which could eventually lead to downsizing or renting with whatever equity is left over after the end of the term.

Let's look at an example. Heather and Jim own their own home and were planning to retire in five years. Heather's mom, Janet, has dementia and they have just received the devastating news that it has progressed to the point where Janet now needs full-time care. Heather would now like to retire early so that she can take care of her mom herself for as long as necessary. Janet wants to stay with them while she can, and she will need medical equipment and in-home nursing care. Jim also plans to stop working to help look after his mother-in-law and spend time with her, as well as to support his wife.

Heather and Jim had planned to save most of their combined disposable income for the next five years, so their savings for their early retirement years are not where they wanted it to be when they stopped working. Setting up a reverse mortgage that allows them to take out a lump sum of $100,000 for medical expenses and home alterations, as well as a tax-free monthly income of $2,500, will get them through this time without having to move house or significantly deplete their investments. In the future, Jim and Heather may decide to go back to work, downsize or continue their early retirement with debt.

A Note about Property Tax Deferral

Many municipalities across the country have programs (generally starting at age 55) to defer your annual property taxes. It's useful to familiarize yourself with these programs when you are heading into retirement. You can plan on using the deferral for additional cash flow for your post-retirement needs. It involves a lien on your property, similar to a secured line of credit or reverse mortgage, so it is best to consider this program only *after* you have set up another home equity program. Otherwise, you may find yourself having to pay back the tax deferral first in order to access additional equity down the road.

Creating Rental Income

The first two strategies involve borrowing money from a financial institution, which means you will be paying interest to that institution for accessing your home equity. Another way to use your home to assist your financial goals would be to generate rental income. If your house can be easily separated into two living spaces, such as by creating a basement suite, this could be ideal. If not, you may be able to rent out a room in your house and share the common living space.

Obviously, a separately divided rental accommodation on the property would be the least intrusive to your daily life, but setting up a rental suite can be costly if there isn't already one in your home. It's best to get estimates for the renovation and consider the time it will take to pay off the debt and how you will pay it. You could use your excess employment income or draw from a secured line of credit and then pay it off with the additional rental income over time. Once the renovation expenses have been paid off, the additional income from your tenant is all yours.

Consider Dave and Elizabeth. Their priority is to retire debt-free, and their goal is to go on three major trips each year once retired. But they are struggling to find the additional savings for this travel goal on top of their current debt repayment, retirement savings and monthly expenses. They are 62 and 63, intend to work until age 65 and want to complete these bucket list trips before they turn 70. Each trip will cost between $10,000 and $15,000. The basement of their two-storey home was updated for their daughter to live in while she was attending university. It wouldn't take much more effort to convert the space into a completely separate suite, and they could likely afford to pay for those renovations with their employment earnings over the next few years. Renting out the basement suite for five years during retirement at $1,000 per month would help them reach their travel budget goals. They also realized that if they move into the suite for a year and rent out the main floor for $2,500 per month, they could even squeeze in a fourth trip.

Creating a rental space in your home is something you can do before retirement to give you additional peace of mind should you want the option of additional cash flow. If setting up a suite is not an option, you could consider a lateral move to a house of the same value that already contains a separate rental suite; or, if you are comfortable sharing common space, you can rent out a room to a friend or a student.

Is It Time to Move?

Downsizing before retirement can be a good way to pay off any outstanding debts, accelerate your retirement date with additional savings towards your income goal or simply create additional cash for an emergency fund or travel budget. How much equity you can access depends on where you choose to live next.

Perhaps you have outgrown your four-bedroom home and the maintenance that comes with it and you would like a smaller bungalow, condo or apartment. Downsizing can also mean staying in a large house but in a different (less expensive) location. Some families I work with end up increasing their property size and increasing their savings by buying a new place with family members, usually children, to create a win-win scenario, with each having proportional ownership.

Downsizing can also mean getting out of the real estate market altogether and renting. This can be a good option for anyone who has significantly underfunded their retirement plans and/or whose health has deteriorated so much that managing a home has become too onerous. If you are considering this option, take the time to familiarize yourself with the rentals available in your area, the rental rates and the locations with easy access to amenities.

To illustrate this scenario, we'll look at Cheryl, who would like to retire mortgage-free, but doing so would mean she would be working for another seven years. She is 60 years old, single and, as a nurse, has a physically demanding job. Cheryl wants to retire now but owes $80,000 on her condo mortgage and is concerned about her financial security. She started looking at smaller condos just outside of town and found some she liked for $150,000 less then she would receive for hers. By moving now, she can pay off her mortgage and put some money in the bank. Downsizing means that Cheryl can eliminate the pressure of having to work longer to pay off the mortgage, while also adding to her retirement savings in a more significant way than she could before.

Downsizing involves selling your current home and moving into one that is less expensive so that you can pocket the difference. It allows you to remain debt-free while still using your home equity towards your retirement goals. Working with your financial advisor to determine the best investment for your newly acquired home equity funds will ensure the best outcome for your personal objectives.

What Is Right for You?

As you consider your retirement income plans, remember that, as a homeowner, you can tap into your home equity to access additional sources of income. It may be as simple as establishing a secured line of credit or as complex as implementing a reverse mortgage. Both these options use the equity you have built up in your home over the years to provide funds you may need; but be aware that they will eventually reduce your net proceeds from the property sale or the value of your estate, and there are additional interest costs and expenses associated with these options.

Accessing home equity is becoming a much more common practice as our real estate prices continue to increase and the cost of living climbs. But before you make any decisions, be sure you know the pros and cons of each scenario. There is no right or wrong solution; there is only what works for your personal circumstances.

Having open conversations with your trusted financial advisor, preferably an independent Certified Financial Planner, and doing your research before selecting a specific option, will help you make an informed decision for you and your family..

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Midori Hillis, BA, CFP® is a Senior Financial Advisor with IPC Securities Corporation who strives to make a positive difference in the lives of others by helping them plan for financial success. She is focused on listening to what matters most to her clients in order to guide them towards achieving their personal goals. Since starting in the industry in 2002, she has been building her own unique Personal Wealth Management Strategy™ to provide families with peace of mind.

Midori holds the designation of Certified Financial Planner from the Financial Planning Standards Council. She is securities licensed by the Canadian Securities Institute and has her life, accident and sickness license through the Insurance Council of BC. She has twice been awarded Investment Planning Counsel's Best Client Experience Award and is a proud member of Advocis, Canada's professional association of financial advisors, and has served on the local board.

Midori thoroughly enjoys calling Vancouver Island her home. She currently resides on a tranquil property in Willis Point with her family, her cats and her ducks. She gives back to her neighbourhood by organizing community events such as the spring swap meet and annual Christmas potluck, editing the local newsletter, arranging food drives, participating in "road cleanup" days and occasionally running the bar at the community hall for various events and fundraisers.

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