How rising interest rates are affecting retirement plans for those with mortgages

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Advisors are doing a lot of number crunching for retiree clients that may lead to decisions, including whether to downsize sooner, stay in their home and change their spending habits, or explore ways to access the equity in their home.
KEVIN VAN PAASSEN/THE GLOBE AND MAIL

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For Canadians retiring with mortgage debt, the likelihood of having to manage higher payments in the near future is a growing concern. With interest rates on the rise, many retirees are working with their advisors to get a sense of the impact of larger housing costs on their cash flow and consider their options – even if renewal is a few years away.

Faced with elevated real estate prices and high inflation, Chris Merrick, a fee-only certified financial planner (CFP) with Merrick Financial Inc. in Toronto, says he's seeing more clients in the Greater Toronto Area carrying mortgage debt into retirement.

"The prices have gone up so much, it isn't always so easy for them to sell and get another [home] in the same area, even if it's a bit cheaper," he says. "So, often clients like to hold onto the house longer with the mortgage just to stay in the current area."

Rising interest rates have left many of these clients with questions about the impact of higher mortgage payments on their lifestyle, Mr. Merrick says. That includes clients holding variable-rate mortgages who may see less of their payment going toward the principal and those with fixed rates looking toward renewal.

"If they're looking to retire now, they were around in the 1980s when the mortgage rates were astronomically high," he says. "A lot of them realize [those rates are] unlikely to happen, but they've lived through that once in their life, so they know it can happen."

In the Bank of Canada's (BoC) Financial System Review, released earlier this year, the central bank analyzed the potential impact of higher mortgage rates at renewal on 1.4 million mortgages with five-year terms taken out at banks in 2020-21.

Assuming these variable- and fixed-rate mortgages renew at median rates of 4.4 and 4.5 per cent in 2025–26, the central bank forecasts that mortgage holders will face an average monthly payment increase of 30 per cent upon renewal.

As many retiree clients' mortgages aren't coming due this year, Mr. Merrick says most haven't had to change their plans yet. Currently, he's working with clients to give them a sense of the impact of higher payments on their cash flow, including stress testing higher rates, and helping them to consider options should the affordability of their mortgage decrease after renewal.

"They can look to the future and see what the monthly cost is going to be. That then leads to bigger decisions such as, 'Do we sell the house and possibly downsize to a smaller one? Do we look at renting?'" he says.

For others, he says, discussions may consider the possibility of increasing their earnings by working longer or getting a part-time job, cutting spending, renting out part of their house, or even a reverse mortgage.

Exploring equity in their homes

Ayana Forward, a fee-only CFP and founder of Retirement in View in Ottawa, is also engaging in proactive discussions with retiree clients as to how a higher mortgage rate at renewal might change their expenses – and the options available if there's a shortfall.

"The last thing you want for someone who's on more of a fixed income is to feel that day-to-day expenses are difficult to meet," she says. "You have to be thinking ahead to what will change in their living costs and do we have sufficient resources to cover that. Are their pensions or savings going to be enough?"

In this environment, advisors are doing a lot of number crunching for retiree clients that may lead to decisions such as whether to downsize sooner, stay in their home and change their spending habits to leave more aside for mortgage costs, or explore ways to access the equity in their home.

The questions go beyond how they'll be able to cover higher payments on a fixed income but also to their ability to requalify for a mortgage, particularly for clients relying on income from investments, rather than a pension, Ms. Forward says.

As a result, she says it's also crucial to give equal weight to "off-the-spreadsheet" conversations to explore clients' lifestyle goals – including whether they want to age in place or are open to moving.

For clients concerned about requalifying for their mortgages, for example, pre-planning may focus on options that eliminate the need to requalify or worry about rising interest rates such as downsizing to a rental property.

How to manage higher payments

While Justin Prasad, financial advisor with BlueShore Financial Credit Union in North Vancouver, says a lot of retiring clients sold their homes and paid off their mortgages during the pandemic, other pre-retirees took out home equity lines of credit or fixed-rate mortgages to help their kids get into the housing market – leaving them open to higher payments after they've retired.

"Before, when people were in a bit of a pinch, they would just sell their single-family home and then downsize and they would realize a nice windfall," he says.

"Now, they're stuck in a situation in which they're not selling and they're stuck with these higher payments."

For these clients, creating cash flow is key. He is working with retirees to look at their budgets to find excess spending to trim, including food costs, to help free up savings to manage the higher payments.

Beyond this, Mr. Prasad advises all clients to talk to their lender about options such as extending their amortization to decrease their payments or using the mortgage's pre-payment option if they have cash available.

Ultimately, with interest rate increases still ongoing, many retiring clients are in the process of shifting their mindset toward the current rate environment – and have only just started to feel the pinch, he says.

"If [rates] continue to move higher and stay relatively high over the next year or two, it's going to be more of a topic of conversation and more clients will be coming to their advisors or mortgage brokers," he adds.

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