

Requirements to Make the Housing Asset a Viable Retirement Asset

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Abstract

A study published in June 2007 performed jointly by the Canadian Institute of Actuaries and the University of Waterloo, entitled *Planning for Retirement: Are Canadians Saving Enough?*, concluded that: two thirds of Canadian households planning to retire in 2030 are not saving adequately to meet necessary living expenses in retirement; and home ownership will help to narrow the gap in savings, but by itself, won't be enough. This study referred to a report by Statistics Canada that showed that in 2005, 69.2 percent of Canadians aged 65 or older owned a home and 88 percent did not have a mortgage. The median value of equity in the principal residence for Canadians aged 65 and older was \$163,400. From the foregoing, I conclude that:

- many Canadians approaching retirement own a home,
- the home and its value are an important part of retirement savings for many Canadians, and
- over their period of retirement many Canadians will need to convert their home equity into retirement income at the same time determining where and how they will be domiciled.

An ideal arrangement would be for home owners to be able to access the equity in their homes to provide retirement income, that the retirement income would be guaranteed to continue for as long as the home owner and the owner's spouse lived, and that the housing asset could be sold or exchanged at any time during the retirement period to accommodate the individuals' changing requirements. In theory, a reverse mortgage could be written to offer these features. However, in practice, the reverse mortgage permits only a fraction of the house's appraised value to be borrowed and is priced in a manner that is unattractive to borrowers. Furthermore, there is no institution that seems particularly well structured to provide the ideal product.

This paper examines the characteristics of an ideal product and the type of institution or institutions that would be well positioned to offer the ideal product. The characteristics of the ideal product include the market mechanisms necessary to permit protection against longevity risk, and risk spreading among financial institutions. The paper argues that a government agency should provide the no negative equity guarantee. With this risk removed from the private sector, pension plans that seek real estate investments could be part of the solution.

In view of the recent bailout of Fannie Mae and Freddie Mac in the United States, any proposal to create real estate-backed investments will be controversial. This paper shows that the proposed investment structure avoids some of the weaknesses that contributed to the need to bail out certain financial organizations. Although the proposed structure is specifically designed for the Canadian economic and regulatory environment, it is anticipated that the characteristics of the ideal product will have global application and the characteristics of the facilitating institutions identified will be helpful to foreign researchers in considering the design of an institution structure that would be appropriate to deliver an attractive reverse mortgage product in their country.