Condo conundrum: How to balance a large down payment without feeling house poor?

DIANNE MALEY
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED FEB 1 2019

At age 29, Zack is in an enviable position. He has a well-paying job, good benefits and a low-rent apartment in downtown Toronto. Because he lives modestly, he is able to save a substantial sum.

Zack’s aim is to buy a place of his own: a condo. He wants to pay 20 per cent down to avoid being saddled with mortgage-insurance fees and he’s wary of taking on too big a mortgage.

In time, he plans to save up to buy a second property to rent out as an investment. His long-term goal is to retire young (at the age of 55) with a modest income ($50,000 a year after tax) and no debt.

“How much house can I afford at a 20-per-cent down payment without ending up house poor while I pay down the mortgage?” Zack asks in an e-mail. How should he invest the money he is saving for a down payment?

We asked Charmaine Huber, a fee-only financial planner at Money Coaches Canada in Barrie, Ont., to look at Zack’s situation.

What the expert says

Zack is living well below his means, saving $2,000 a month after his lifestyle expenses are accounted for, Ms. Huber says. A further $2,055 of his pay is going to his defined-contribution pension plan and stock-purchase plan, for total monthly savings of more than $4,000.

Zack has $68,000 in his tax-free savings account, about $50,000 in non-registered investments and $16,000 of guaranteed investment certificates. As well, he has about $36,000 in a registered retirement savings plan. He could take advantage of the federal Home Buyers’ Plan, which would allow him to borrow up to $25,000 from his RRSP without paying tax, the planner says. The funds would have to be paid back over 15 years.

“This would give him a total of $159,000 to put toward a down payment,” Ms. Huber says. He would also need funds for closing costs. He has $11,000 set aside for an emergency fund that he could use for this purpose. Or he could continue saving for a few more months until he has more cash. Any funds destined for his down payment in the short term should be kept in cash and cash equivalents, she says.

With a down payment of $159,000, Zack could spend up to $795,000 without needing Canada Mortgage and Housing Corp. insurance, “but this would probably make him feel
house poor,” Ms. Huber says. The average Toronto condo costs more than $500,000. “He will likely want to stay within the $500,000 range,” even if it means moving out of the city centre and commuting to work.

If Zack buys a $550,000 condo with a down payment of $159,000, he would have a $391,000 mortgage. Using today’s average five-year mortgage rate of 3.4 per cent, amortized over 25 years, this would cost him $1,932 a month.

He would have to take into account the additional costs that come with owning a home: condo fees (estimated at $500 a month); property insurance ($50); property tax ($175); utilities ($120); and home maintenance ($100 or more). His total monthly housing costs would be about $2,875. “Since he is paying rent of $875 a month and has a $2,000-a-month cash surplus, this scenario is feasible,” Ms. Huber says.

Longer term, Zack hopes to retire from work at the age of 55. He will have some income from his defined-benefit pension plan (with a previous employer), and his DC pension plan, the value of which will depend on financial markets. He will need to draw on his savings to make up the expected shortfall, especially between ages 55 and 65, when he will start getting Canada Pension Plan and Old Age Security benefits, the planner says.

Retirement is a long way off for Zack, but he should easily be able to achieve or surpass his modest spending goal, Ms. Huber says. All he needs to do is continue to contribute the maximum each year to his TFSA, RRSP and stock-purchase plan at work.

Zack is already saving $1,500 a month to his stock-purchase plan, which he reallocates to investments of his choice each quarter, she notes. As well, he is in line to get a yearly bonus, which he could invest for the long term as well.

If in future he chooses to use some of his long-term savings to buy an investment property, he will have to assess how this will affect his retirement plans, Ms. Huber says. He would end up with less savings, but he would have rental income to help support his retirement needs. “Or he could sell the property for a profit at some point.”

Client situation

The person: Zack, 29

The problem: How much can he spend on a condo without feeling house poor?

The plan: Settle for a condo price and mortgage that he would feel comfortable with – and that would not stretch him financially – even if it means moving out of downtown.

The payoff: Financial security and a greater chance of achieving long-term goals

Monthly net income: $6,655

Assets: Non-registered investments $50,100; RRSP $36,400; TFSA $68,000; GICs $16,000; cash $11,000; commuted value of DB pension (previous employer) $84,000; market value of DC pension plan $4,200. Total: $269,700
Monthly outlays: Rent $875; tenant insurance $10; transportation $395; groceries, clothing $190; gifts, charity $130; vacation, travel $360; personal care $45; club membership $35; dining, entertainment $225; subscriptions, other personal $40; dentist $30; cellphone, internet $75; pension plan contribution $555; stock purchase plan $1,500. Total: $4,465. Surplus of $2,190 goes mainly to RRSP, TFSA and other savings.

Liabilities: None