FINANCIAL FACELIFT

Is it too late for this saleswoman to re-enter Toronto's real estate market?

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Special to The Globe and Mail
Published Friday, Jul. 03, 2015 4:21PM EDT
Last updated Friday, Jul. 03, 2015 7:36PM EDT

When her daughter was born, Dorrie sold her one-bedroom Toronto condo and moved to a larger rental apartment, a move she sorely regrets now.

"In hindsight, I should have rented [the condo] out," Dorrie writes in an e-mail. "It would have been paid off by now and worth a small fortune because it had a view of the lake," she adds. "The real estate market has surged and I am feeling left behind."

Dorrie, who is 48, earns $123,000 plus commission in her high-level sales job.
She also gets $500 a month in net rental income from a condo in Florida.

She wants to get back into the real estate market – she has $200,000 sitting in a bank account collecting next to nothing in interest – but she's apprehensive about prices. She figures she'd have to pay $650,000 to $700,000 to buy in her neighbourhood.

"I am wondering if I should be taking out a $500,000 mortgage," Dorrie writes. "I am honestly losing sleep over this. The housing market is crazy and I am very concerned that it may be too late for me to enter the market."

If Toronto is beyond her reach, she wonders if she should invest in another U.S. property.

She also wonders whether she is contributing too much to her registered retirement savings plan. She has a defined-contribution pension plan (similar to an RRSP) at work where her employer matches her contributions. "How much is too much RRSP?"

We asked Noel D'Souza, a fee-for-service financial planner at Money Coaches Canada in Toronto, to look at Dorrie's situation.

What the expert says

Whether it's the stock market or the real estate market, Dorrie needs to think about why she is investing, for how long and what the prospects for an acceptable return over the holding period might be, Mr. D'Souza says.

Dorrie is thinking of buying a home in the $650,000 price range. She would have a down payment of about $208,000 (including $25,000 from her RRSP under the federal Home Buyers' Plan) and closing costs of about $14,000. A mortgage at 3 per cent amortized over the 17 years she has left before she retires at age 65 would cost about $2,800 a month.

"Depending on the estimates used for property taxes, insurance, utilities and home maintenance expenses, there could be another $1,300 a month in home ownership costs, bringing the total close to $4,100 a month," Mr. D'Souza says. This compares with the $1,800 a month she currently pays in rent.

Dorrie would have to free up about $2,300 a month to pay for the additional housing costs. This would require substantial spending cuts, "perhaps so much so that her enjoyment of life with her daughter would be adversely affected," he says. Because Dorrie is the sole breadwinner, a job loss would severely hamper her ability to make ends meet without drawing on her savings.

"Given Dorrie's numbers, I don't see a $650,000-plus home purchase in the GTA being a good investment from either the risk or reward perspective," Mr. D'Souza says. She'd be better off buying a less expensive property – say $450,000 – in an up-and-coming area with good future investment-return potential. With a $450,000 property, she would have a $250,000 mortgage, which would cost about $1,550 a month. Additional ownership costs would be about $1,000.

"This would result in a much more manageable $2,550 a month for housing and still allow Dorrie to pay off the home by the time she retires," the planner says. "Most of the additional costs of ownership would be covered by reducing her RRSP contributions."

What if Dorrie opted to stay put and not buy a home? Given her high marginal tax rate, Dorrie would benefit from maximizing her RRSP contributions – and getting the company's matching contribution – with any additional surplus going to her tax-free savings account, Mr. D'Souza says. "Although this would result in a very sizable RRSP, it does make sense in this case due to Dorrie's very high current marginal tax rate." Her tax rate "will likely be much lower in retirement."

Dorrie worries about her rent rising over time but, given her savings, she should be fine if she continues to rent rather than buy, the planner says. With a projected 5 per cent return on her investments (now $675,000) and a 3 per cent return on her U.S. condo (worth $148,500), plus $16,800 a year in savings, Dorrie should have about $2.2-million in assets by the time she retires at age 65, the planner says. This, together with government benefits, would give her an inflation-adjusted income of about $69,000 a year until her mid-90s. That assumes she sells her U.S. investment property at some point.

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The person: Dorrie, 48, and her daughter, age 8

The problem: Has the Toronto real estate market become too pricey for her to get back in?

The plan: Consider buying a much less expensive place or renting and investing her $200,000 in cash

The payoff: Financial security

Monthly net income (excluding bonus): $6,100

Assets: Bank account $200,000; RRSP and defined contribution pension plan $459,000; TFSA $16,000; RESP $38,000; investment condo $148,500. Total: $861,500

Monthly disbursements: Rent (includes Internet and TV) $1,800; life insurance $190; car lease $285; RRSP $1,400; RESP $220; car insurance $195; car maintenance $20; charitable $200; line of credit $245; groceries and cleaning supplies $400; gasoline $200; miscellaneous transportation $80; entertainment, dining out, movies $400; clothing, shoes $200; hobbies, classes $100; personal trainer $600; subscriptions $15; travel, vacation $335. Total: $6,885

Liabilities: Line of credit on investment condo. Total: $74,000