Expat Financial Planning: Keep Housing Affordable to Save More for Retirement

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For expats who are considering a home purchase, buying a less expensive house can be difficult—for most of us, costlier homes simply seem more desirable. But you should be aware of the trade-off: By sacrificing a little size and whatever other amenities the more expensive home has, you can add significantly to your retirement savings. As an example, in our case study below we show how additional retirement savings of almost USD 1.2 million may be possible.

Purchasing property is one of the biggest decisions we see expats make, but this decision is typically clouded by a couple of things. The first is to mistakenly view each property purchase as an investment, even when it is not. The second is to not clearly understand how much house you can afford and what the potential impact of buying too much house will have on your retirement portfolio.

Buying a personal home should generally be considered consumption, not an investment. A home can hold value, meaning the price can be expected to rise over time with the rate of inflation. But this will be at a lower rate than the return on a well-constructed investment portfolio, especially when you consider all the costs of property ownership. And although you could get lucky with home price appreciation, you could get unlucky too; and hoping to get lucky is never an investment strategy.

The use of leverage in this case does not generally increase the return. It just allows you to consume today rather than saving and consuming in the future—a privilege for which you pay dearly.

An Expat Family Example

Before we get into the numbers of how much can be saved when buying a less expensive home, here is a breakdown for a typical expat family:

John and Mary Expat are both 45 and have two young children. John is a professional working for a multinational, earning USD 100,000 per year. Mary had a professional career before relocating overseas, but she has decided to support her husband's career and is now an accompanying spouse. They have saved diligently and accumulated an investment portfolio of USD 500,000. They estimate that they can continue to save USD 20,000 per year before retirement at age 65. Their major goals, besides providing a sound education for their children, are to save for retirement and to purchase a retirement home in their home country.

They have two primary assets to achieve their goals: John's income and their investment portfolio. Assuming John's salary increases at a rate of 3% per year, he will earn a total of USD 2,867,000 over the next 20 years before retirement. From this, they have to pay annual living expenses and save for the future.

Like many expat families, they plan to focus on saving and managing their portfolio. They can do a lot more for their retirement portfolio, however, by taking the savings from buying a cheaper home and putting it into their portfolio.

Saving More with Less

According to the U.S. Federal Housing Administration, the average family can afford mortgage payments of between 29% and 41% of gross income. Let's assume the expat couple above is considering one house valued in local currency at USD 600,000 and another at USD 800,000.

With a 30-year mortgage at 6% and a 20% down payment, the mortgage payment would be USD 2,878 on the first house and USD 3,837 on the second, for a difference of USD 959 per month. This puts the mortgage payment at 35% of gross income for the first house and 46% for the second. This may not seem like that much difference, but the impact on the couple's retirement portfolio alone could make this a million-dollar decision.

If this family bought the more affordable house and invested the difference in mortgage payments each month in their retirement portfolio, they would accumulate an additional USD 1,163,000 over the 30-year mortgage period. This is important since it is the portfolio that is going to have to produce the bulk of the cash flow required to cover their living expenses and other goals in retirement.

It is true that some of that value would accrue in the more expensive house, but most of the value is paid away in increased mortgage interest. Additionally, on average, property values can be expected to increase around the rate of long-run inflation, significantly less than what your portfolio should be producing. To unlock this value, the couple would have to downsize their property, take out a home equity loan, or use a reverse mortgage, none of which is really cost-effective or may even be possible.

This article is a revised and updated version of one that had appeared previously on www.crevelingandcreveling.com.

Additional Resources

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Expat Case Study: Evaluating a Buy-to-Rent Condo Investment

Expat Americans: What You Need to Know Before Buying a Home Overseas