

Many retirees are planning to access home equity, hoping it may make the difference between a comfortable retirement and just getting by. This article considers some of the strategies for tapping home equity, such as moving to a more affordable residence or obtaining a reverse mortgage.

### **Before You Start**

- Talk with your spouse or partner about using your home to help finance retirement. Are you in agreement?
- Consider whether your plans are realistic. For example, ask yourself whether you could really downsize to a smaller home.
- Begin looking into the cost-of-living implications that would be associated with moving to a different part of the country.
- Check your most recent retirement account statement to determine whether you're already contributing the maximum amount.

### **Your Home and Your Retirement**

Unlike earlier generations of retirees, who paid off first mortgages and retired at the family homestead, today's Baby Boomers are looking to capitalize on home equity to enhance their retirement savings. Popular strategies for tapping home equity include downsizing to a smaller house or condominium, relocating to an area where the cost of living is more affordable, and taking out a reverse mortgage.

Regardless of which strategy you choose, it's important to be realistic about what your house may be worth when you retire. Although housing prices have escalated considerably during the past few years, a variety of factors may cause them to level off or decline at some point in the future. Home equity may add value to a diversified portfolio, but relying too much on your house to fund your retirement could work against you if the real estate market in your area cools considerably.

## **Making a Move**

Selling your existing home and relocating to a more affordable house or condominium may be a reasonable option if you have considerable home equity and the shift won't negatively affect your lifestyle. As part of your research, remember to investigate the overall housing costs in your desired area. For example, real estate values and property taxes typically vary considerably by locale, sometimes even within the same state. Additionally, before relocating to a new area, you might want to spend significant time there to make sure it is compatible with your lifestyle and interests.

When calculating your home's sale price as part of the retirement income equation, be sure to use realistic assumptions. Real estate prices have risen at above-average rates in recent years (see table on average annual rise in home prices, below), and there is always the potential that they may level off or even decline in the future. When planning your retirement income, remember the importance of diversification -- owning a portfolio of stocks, bonds, and cash investments in addition to home equity -- to help guard against market swings in any one area, including real estate. Of course, there are no guarantees that a diversified portfolio will protect against overall financial losses, but a diversified portfolio can position you to potentially take advantage of gains in several financial sectors.

Finally, when selling your home, consider that the first \$250,000 in capital gains (\$500,000 if you sell jointly with a spouse) is not subject to federal taxation if you lived in the house for two years or more.

## **A Reverse Mortgage: A Tool for Staying Put**

Tapping home equity doesn't necessarily require relocating. A reverse mortgage may be a solution if you have significant home equity and a desire to stay in your existing home. With a reverse mortgage, you receive a source of income by borrowing against your home's equity. Payouts are tax free and may be taken as a lump sum, a line of credit, or an annuity-like payment schedule.

To qualify, you and other owners (such as a spouse or partner) must be at least 62 years of age. You must own your home outright or be able to retire an existing mortgage with the money you receive from the reverse mortgage. As long as the reverse mortgage is in effect, you are responsible for maintaining your home, and for paying taxes and insurance. The loan plus accrued interest is due when you die or sell the house.

When evaluating a reverse mortgage, be sure to consider the fees, which may be substantial. You may have to pay a loan origination fee of between 6% and 8% of the value of your home, in addition to servicing fees assessed over the term of the mortgage. Because of the relatively high fees, many experts recommend a reverse mortgage only if you plan to remain in your home for the long term. Also keep in mind that the amount you owe tends to grow over time, as interest (which is usually based on a variable, rather than fixed, rate) accrues on amounts that are gradually paid out. Over time, a reverse mortgage can completely exhaust the value of your home, leaving little if any assets left over for your heirs.

## Payout Alternatives

Study payout options associated with a reverse mortgage carefully to determine whether one may work for you.

<b>Payout Option</b>	<b>Advantages</b>	<b>Drawbacks</b>
Lump sum	You receive a considerable sum.	Interest accrues on the entire amount.
Line of credit	You have the flexibility to draw only as much as you need.	Fees may outweigh the benefit if you draw only a small amount.
Annuity-like schedule	You may receive a source of income for as long as you remain in your home.	Payments are not indexed to inflation.

The recent boom in the national housing market may have lulled many Baby Boomers into believing their home equity will be enough to see them through a comfortable retirement. If you're among those who intend to rely on a home's value -- either through downsizing, relocating, or obtaining a reverse mortgage -- make sure that your plans include realistic projections. And remember that maintaining a diversified portfolio of other types of investments can potentially help balance out your overall pool of financial assets.

<b>The Average Annual Rise in Home Prices: Compare Recent Years with Historical Averages</b>		
	<b>2000-2004</b>	<b>1975-2004</b>
<b>New York</b>	10.65	6.81
<b>Ohio</b>	4.28	4.81
<b>Texas</b>	4.39	4.15
<b>California</b>	14.46	8.51
<b>U.S. Average</b>	8.17	5.78
Source: Office of Federal Housing Oversight, OFHEO House Price Index, 2004 data as of September 30 (most recent available).		

## Summary

- Strategies for accessing home equity may include selling your house and moving to a smaller residence, relocating to a community where the cost of living is more affordable, or obtaining a reverse mortgage.
- Because real estate values may potentially level off or even decline, it's important not to rely too much on the value of your home to finance your later years. Consider using home equity to supplement a diversified portfolio that includes stocks, bonds, and cash investments.
- Accessing home equity by selling your house may have the greatest appeal if you are able to find alternate housing without significantly compromising your lifestyle.
- A reverse mortgage may work for homeowners who have considerable home equity and want to remain in their current residence. Payout options typically include a lump sum, a line of credit, or an annuity-type schedule of payments.
- When evaluating reverse mortgages, review the fees and overall cost of borrowing (total interest paid over time), which may be considerable.