House Money

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As 401(k)s shrink and Social Security replaces a smaller share of income, retirees may need to reconsider tapping the value in their homes.

Is home equity an underutilized asset in retirement planning? Traditionally financial advisors and retirees alike tend to leave the home out of the equation when it comes to retirement planning. Older generations considered the home something to be preserved, paid off free and clear before retirement and left to heirs as a legacy.

"Historically, the previous generation was dead set against ever using the house to fund retirement," says Brad Davis, vice president of retirement income solutions for Nationwide Financial. And financial planners often view their job as asset preservation rather than the drawing down of assets. "When advisors talk to clients about assets for retirement, home equity really hasn't been part of that discussion," says Sandra Timmerman, director of the MetLife Mature Market Institute (MMI).

But many in the industry now think it is time to reconsider home equity as an integral part of a client's long-term portfolio and to figure out strategies for leveraging clients' homes that go beyond basic reverse mortgages. Protecting home equity "may be a luxury that future retirees can ill afford as Social Security replaces a smaller share of preretirement incomes, and people rely increasingly on meager 401(k) balances rather than traditional pensions," according to a March 2010 report from the Center for Retirement Research (CRR) at Boston College.

RECONSIDER THE HOME

In fact, research suggests that failure to tap home equity may lead to undue hardship in retirement for boomers. The decision not to tap home equity through a reverse mortgage increases the percentage of retirees in danger of being unable to maintain their preretirement standard of living to 61% from 51%, according to CRR. Today's retirees face more pressure on limited resources due to increased longevity and the potentially devastating cost of long-term care. Many have no defined benefit plans and may have to care for their parents as well as help out their children financially.

Reverse mortgage products have had limited appeal. Only 2% of those eligible have used a reverse mortgage, according to CRR. Advisors tend to view these heavily regulated products as complicated and expensive, used primarily by seniors in lower income brackets as a last-ditch solution.

Yet seniors have a sizable portion of their net worth tied up in their homes. In today's economy, even affluent clients may need to reconsider utilizing their home equity as a resource. "A lot of affluent people have been hit hard by the stock market crash, lost their shirts investing in real estate or perhaps their golden parachute or retiree pension has evaporated," says Barbara Stucki, PhD, director of the Reverse Mortgage Initiative for the National Council on Aging. "What may at one point have seemed like a secure future may seem less so now, and they may need to fall back on assets [such as the home] they once would not have considered using."

STRATEGIC ASSET

In fact, conventional attitudes toward home equity appear to be changing. "Households are entering retirement carrying mortgages on more expensive houses," says Tony Webb, PhD, associate director of research at CRR. "It may be a very, very nice house, but it doesn't put food on the table, and a large mortgage is an expense that has to be met every month."

The proportion of homeowners aged 65 and older who have some type of home loan has grown significantly in recent years, to 32% in 2007 from just 24% in 1999, according to a June 2009 study by MMI and the National Council on Aging. The study also found that 51.9% of households with incomes of at least $40,000 and homes worth $250,000 or more were still making monthly mortgage payments. Faced with the question of how to fund their retirement, such homeowners may be interested in exploring ways to tap their housing-related wealth.

"Ultimately planners need to think about home equity as a strategic asset in retirement, rather than simply an asset to be preserved, because a lot of people are making dumb mistakes such as taking on high interest credit card debt or depriving themselves of a lifestyle," says Stucki, who led the MMI study. "I'm not encouraging people to tap the equity in their home-it may not be the best choice-but it should be an important conversation. And it should be done in a strategic and orderly way, not in a moment of crisis."

Talk with your clients about these different ways of unlocking home equity in retirement:

* *Take a home equity loan?* While home equity loans are relatively low cost, they are not an ideal solution in retirement since they create another monthly bill without reducing housing expenses. "It's pretty cheap money, but it's best used for short-term goals, such as buying a car, when you don't want to liquidate your stock portfolio," suggests Kevin Meehan, a certified financial planner with Summit Wealth Advisors in Itasca, Ill.

* *Downsize your home?* Advisors should help clients evaluate whether it makes sense to downsize their home. "Are the housing costs really affordable in the long run? It may be more appropriate to downsize now when the household is fit and healthy, rather than wait to do it in a crisis," Webb says.

Many people live in big homes that are sparsely utilized, Meehan says. If they need to create income from the equity in their home, they should sell the home. This will bring expenses down, lower property taxes, cut down on insurance and lower utility bills.

Clients may argue that they want to try to hold on to the home as a nest egg, which could be sold in case of a real crisis such as a healthcare emergency. "But what we've learned is that a house is an illiquid asset; there is uncertainty in the house that isn't in a 401(k)," Meehan says. "You may not be able to sell, and the value of your house can fluctuate drastically. This notion that 'I'll just sell it' may come up short."

* *Unload the second home?* Financial advisors report a common pattern with retirees who own a vacation home. Over time, one home often becomes dramatically underutilized, in part because the older people get, the less they want to travel.

Meehan suggests doing the math with clients. A frank discussion may convince clients that selling the less used home is a practical way to release equity for retirement.

"Figure out how much it costs them each day they're there. If it turns out that it's $500 a night, you might as well stay at the Four Seasons anywhere in the world, rather than being tied to a particular beach in Florida," Meehan explains.

* *Explore a reverse mortgage?* Most planners think of reverse mortgages as relatively blunt instruments, expensive and best reserved for financial crises. However, recent developments signal that this product is evolving. In March,

one of the largest providers of reverse mortgages, MetLife, took the step of eliminating origination and servicing fees on its fixed-rate product.

"Clearly reverse mortgages have been perceived as products that come with high upfront costs. We felt it was time to make a fairly bold move-reduce costs by eliminating the origination and servicing fee-and improve the value proposition," says Craig Corn, vice president of reverse mortgages at MetLife Bank.

In recent months other reverse mortgage lenders, such as Generation Mortgage, have also done away with servicing fees. "These days the person with the high-value home may have little or no upfront costs, and he or she can get a huge reverse loan," Stucki says

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