A retirement
PLANNING GUIDE

USING YOUR HOUSE *for* INCOME IN RETIREMENT

It's something Americans increasingly need to consider. And increasingly need to do.

CENTER *for* RETIREMENT RESEARCH *at* BOSTON COLLEGE

A retirement *PLANNING GUIDE*

By Steven Sass,
Alicia H. Munnell and
Andrew Eschtruth

*Art direction
and design by*
Ronn Campisi, Ronn
Campisi Design

CENTER *for*
RETIREMENT
RESEARCH
at BOSTON COLLEGE

The Center for Retirement Research at Boston College aims to help Americans make smart financial decisions throughout their lives.

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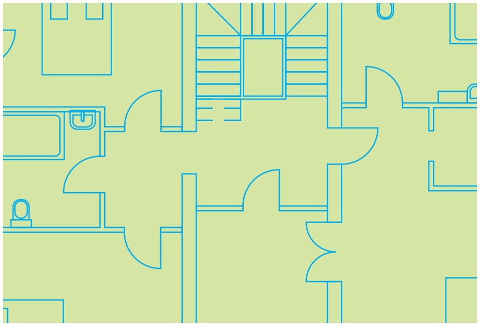

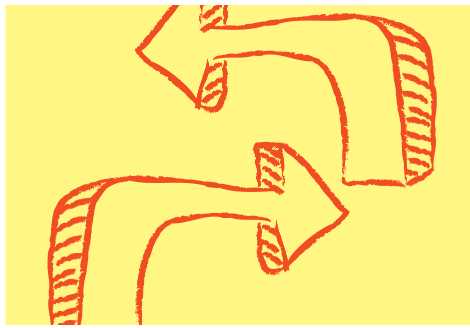

USING YOUR HOUSE *for* INCOME IN RETIREMENT

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It's mainly used as a reserve or bequest. It could also be used for income.

It could be better suited to your life in retirement.

How much you could get as a lump sum, line of credit, or monthly payments.

Your house is likely your largest store of wealth. If you need more income, it's the logical place to look.

Your house is your home

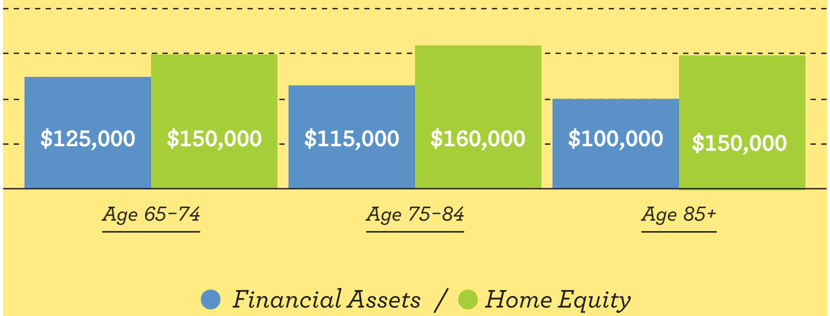
It's where you feel most comfortable, spend the most time, develop friendships, and build community.

It's also a large store of wealth

If you're like most retirees

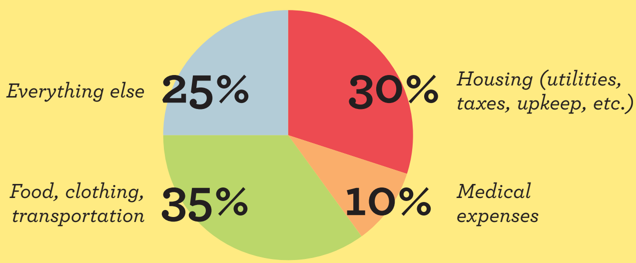
Home equity — the value of your house less any mortgage — is your largest store of wealth

MEDIAN HOME EQUITY AND FINANCIAL ASSETS, TWO-PERSON HOUSEHOLDS



Housing is often your biggest single expense

DISTRIBUTION OF EXPENDITURES, RETIRED COUPLES AGE 65-74



It's also where lots of income goes

AUTHORS' CALCULATIONS FROM THE 2010 WAVE OF THE *HEALTH AND RETIREMENT STUDY*.

How retirees use their house today

Owning your home lets you live rent-free, with no landlord who could raise your rent or ask you to move.

HOME EQUITY, the portion of the house you own, is also used as:

A reserve, mainly for health-related costs down the road.

HEALTH EXPENSES *rise with age and many will spend time in a nursing home, which is very expensive and NOT covered by Medicare.*

SOCIAL SECURITY *and other continuing income will cover part of the cost. But savings, insurance, Medicaid — or home equity — must cover the rest.*[1]

A bequest, left to children or charity.

You can also use your house for income

Many more retirees will need to use their house to boost their income.

That's because traditional sources provide less than they did in the past.

- Social Security now replaces a smaller share of what you earned while working.[2]
- 401(k)s typically provide less income than the employer pensions they replaced, and the income they provide is less secure.

Two ways to use your house

1. Downsize to a less expensive house

2. Take out a reverse mortgage

What can downsizing do?

Downsizing — which means moving to a less expensive house, not just a smaller house — increases your income in two ways. It can:

ADD TO YOUR SAVINGS & INCOME FROM SAVINGS. The difference in house prices, after selling and moving costs that typically run about 10% of the value of your house, adds to your savings.[3] If you add $75,000, as in the example on the opposite page, you can:

- **INVEST THE PROCEEDS** *and draw out about $3,000 a year, rising in line with prices for the rest of your life.*[4]
- **DELAY STARTING SOCIAL SECURITY,** *up to age 70, and increase your income about $4,500 a year, also rising in line with prices for the rest of your life.*[5]

CUT YOUR EXPENSES & FREE UP INCOME. Downsizing can free up income needed to pay taxes, insurance, upkeep, and utility bills, which typically run about 3.25% of the value of a house.[6]

If you downsize from a $250,000 house

To a house that costs $150,000, you'd:

ADD TO YOUR SAVINGS & INCOME FROM SAVINGS	
Difference in house prices	$100,000
Selling & moving costs	– $25,000
Added to savings	$75,000
INCREASE IN YEARLY INCOME (4% OF $75,000)	$3,000

CUT YOUR EXPENSES & FREE UP INCOME USED TO PAY THOSE EXPENSES	
Current expenses (3.25% of $250,000)	$8,125
New expenses (3.25% of $150,000)	– 4,875
YEARLY INCOME FREED UP (3.25% OF $100,000)	$3,250

You'd have $6,250 more each year

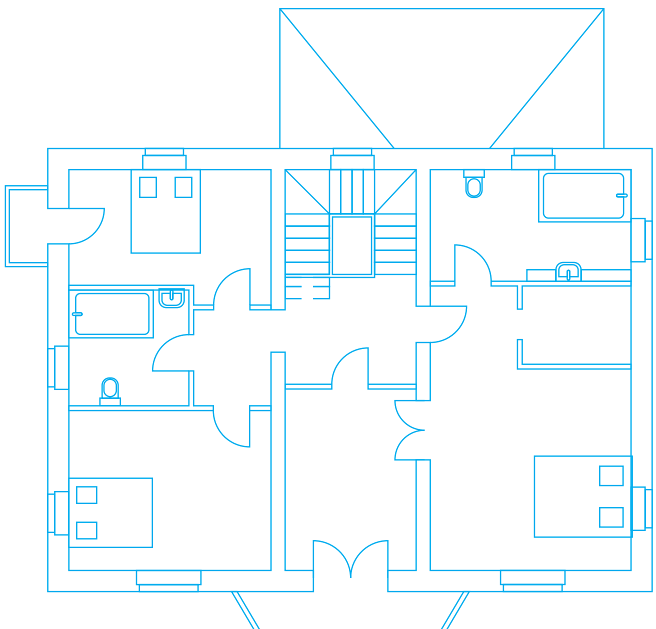
ONLINE To see what downsizing could do for you, use our calculator: *http://squaredaway.bc.edu/calculators/move-or-stay-put*

Is a less expensive house better?

It can be, if your current house is suited to an earlier stage in life — with more stairs and rooms than you need, in a neighborhood with schools and playgrounds you no longer use, near where you no longer work.

DOWNSIZING COULD GIVE YOU a house more suited to a life in retirement.

- **THE RIGHT NUMBER OF ROOMS** *and a layout you could live in as you age.*
- **A NEIGHBORHOOD THAT OFFERS:**
  - → *Things you enjoy — whether it's nature, family, or coffee shops.*
  - → *Easy access to things you need — shopping, entertainment, and medical care.*



If downsizing makes sense, don't wait

Yes, moving is difficult and time-consuming. It means leaving memories and the comforts of home. But if downsizing makes sense, the sooner you move the better.

Moving becomes more difficult with age, both physically and socially.

The sooner you downsize, the sooner you increase your income and cut your expenses.

If you put it off to tomorrow, when tomorrow comes you'll likely put it off again.

What can a reverse mortgage do?

A reverse mortgage lets you stay in your house and tap the equity in your home to pay for your needs in retirement. Here's a quick primer:

A reverse mortgage is a mortgage — a loan backed by your house as collateral.

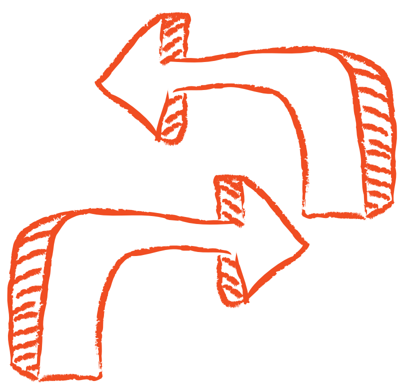
You must be 62 or older to get a federally insured Home Equity Conversion Mortgage (HECM) loan — and essentially all reverse mortgages today are HECM loans.

You only need to repay what you owe when you move, sell your house, or die.

- **YOU CAN STAY IN YOUR HOUSE** *without making any loan payments.*
- **WHAT YOU BORROW**, *plus interest, reduces the home equity you own.*
- **YOU WILL NEVER OWE MORE** *than what your house is worth.*

The money you get is a loan, so it's tax-free.

- **IT DOES NOT AFFECT** *costs pegged to your "income," such as Medicare premiums or how your Social Security benefits are taxed.*
- **IT DOES NOT AFFECT** *your eligibility for Medicaid or Supplemental Security Income — if you spend what you get within a month.*



Ways to use a reverse mortgage

A reverse mortgage can provide:

A LINE OF CREDIT[7] THAT CAN BE USED AS:

- A reserve to pay for rising or unexpected expenses.
- A source of income for everyday needs.[8]

A LUMP SUM THAT CAN BE USED TO:

- Pay off an existing mortgage, which would cut your fixed expenses and free up income for other uses.
- Modify your home so that you can "age in place" more comfortably.

MONTHLY PAYMENTS — EITHER FOR LIFE OR A SET PERIOD OF TIME:

- Payments for life are an income you can't outlive. These payments, however, do NOT increase with inflation. So they buy less as prices rise.[9]
- Payments for a set period of time, which can be used to delay claiming Social Security and increase your monthly Social Security benefits.

How much can you get?

It depends. You can get more:

- **THE MORE VALUABLE YOUR HOUSE** *(up to $625,500).*
- **THE LOWER THE INTEREST RATE** *(you'll owe less interest when the loan is repaid, so your house will support a larger loan).*
- **THE OLDER YOU ARE** *(you'll also owe less interest when the loan is repaid, so your house will support a larger loan).*

YOU MUST FIRST use the proceeds to pay off any existing mortgage. This eliminates monthly mortgage payments, but reduces what you'd otherwise get.

What you could get on a house worth $250,000, net of $8,250* in fees[10]

AGE	LUMP SUM *	LINE OF CREDIT *	LIFETIME YEARLY PAYMENTS
65	$127,000	$118,500	$8,600
70	$133,000	$125,500	$9,500
75	$139,000	$132,500	$10,700

* In the first year you can only draw 60% of the gross amount (what you get + fees) unless you need to draw out more to pay off a mortgage or make required repairs. But if you draw more than 60%, your mortgage insurance fee at closing rises from 0.5% to 2.5%, adding $5,000 in fees and reducing what you'd get, net of fees, in this example.

Fees explained

Fees on a HECM reverse mortgage include:

- ORDINARY MORTGAGE FEES — an appraisal, legal fees, and the like.
- ORIGINATION FEE — to cover lender expenses.[11]
- MORTGAGE INSURANCE — to insure that you get all promised payments and that the bank is repaid, even if the value of your house, when sold, is less than what you owe.
  - 0.5% of the house value at closing (but see the note on the opposite page).
  - Plus 1.25% added to the interest rate.
- SERVICE FEE — to cover projected servicing costs — now often waived.

While fees vary by lender, reasonable estimates on a house worth $250,000 are:

Ordinary fees	Origination	Mortgage Insurance	TOTAL	% of house value
$2,500	**$4,500**	**$1,250**	**$8,250**	**3.3%**

Fees are a larger % of a less expensive home and a lower % of a more expensive home.

Is a reverse mortgage right for you?

A reverse mortgage could be right if:

- **YOU WILL STAY IN YOUR HOUSE** *for the rest of your life.*
- **YOU WON'T NEED THE EQUITY** *for nursing home care or bequests.*[12]
- **YOU AND YOUR SPOUSE ARE BOTH AGE 62** *or older and can be borrowers on the loan. As the house does not need to be sold until all borrowers die, the survivor will NOT be forced to move.*
- **YOU'LL BE ABLE TO PAY TAXES AND INSURANCE.** *If you can't, you probably can't get a HECM loan. If you get a loan but don't pay taxes or insurance, you'll be in default and could LOSE your home.*

To see if it's right

The Department of Housing and Urban Development website has more information, a calculator, and contact information for approved housing counselors.

ONLINE *http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmhome*

You MUST meet with a government-approved counselor to apply for a HECM loan. To benefit from the meeting, make sure you understand:

- The costs, benefits, and risks of the different types of reverse mortgages.
- Your alternatives, including conventional home equity lines of credit, which have lower fees and interest rates and could be a better option if you plan to repay the loan.
- How to avoid scammers targeting the proceeds of the loan — typically sellers of bogus, inappropriate, or overpriced investments or home improvements.

Two options compared

If you're 65 and own a $250,000 house:

OPTION 1

DOWNSIZE TO A $150, 000 HOUSE

YOU WILL:

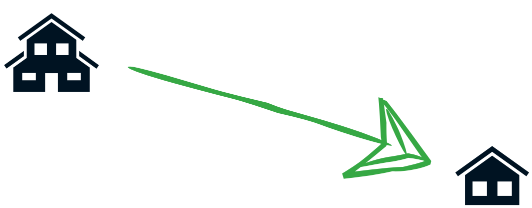
- **ADD** *about $6,250 to your income, rising with prices.*
- **GIVE UP** *your current home, to live in a less expensive home.*
- **PAY** *about 10 percent of the value of your house.*
- **KEEP** *proceeds from the sale and equity in your new home.*

OPTION 2

GET A REVERSE MORTGAGE

YOU WILL:

- **ADD** *about $8,600 to your income, not rising with prices.*
- **GIVE UP** *equity you can tap as a reserve or leave as a bequest.*
- **PAY** *about 3.3 percent of the value of your house.*
- **KEEP** *living in your current home.*



Order counts!

If you need more income and it makes sense to use your house to get it:

- Consider downsizing first. You want to be in the “right” home for retirement as soon as you can. And it’s costly to downsize after taking a reverse mortgage, as the fees and interest will reduce the equity you have in your current home.
- Consider a reverse mortgage if you’re in the “right” home — to get more income, pay off a mortgage, or secure a line of credit you can tap if need be.

Using your house in retirement

Your house has many uses. It's your home. It's wealth you can use as a reserve or bequest. And it's a potential source of income. How you use it depends on what you need and value.

The keystone of your finances

Once you retire, you basically have what you have.

- To improve your finances, you can adjust how much you spend each month or fiddle with how you invest your savings.
- Using your house, however, is generally the most powerful way to see that your bills will be paid.

You built up the equity in your home by paying down the mortgage and keeping your house in good repair. Now use it to make your life in retirement better.

Explanations

1. Nursing home costs average about $75,000 a year, though costs vary widely. You don't need reserves to cover the cost if 1) you'll be eligible for Medicaid, the government program that covers the cost for those with low income and assets — and your house is generally not counted if it remains your home or the home of your spouse; OR 2) you have long-term care insurance, which costs about $2,500 per person per year.

2. Social Security benefits replace less mainly due to the rise in the age you can claim "full benefits" and the increased employment of married women — which has raised pre-retirement household income far more than household Social Security benefits.

3. The proceeds are generally tax-free if you owned the home at least two years and the capital gain — the sales price less selling costs and the price you paid — is less than $500,000, or $250,000 if single. See IRS Publication 523, *Selling Your Home.*

An illustration of selling and moving costs for a house that sells for $250,000:

Fix up house to sell	Commission (5%)	Moving	Fix-up new house	TOTAL	% of House Value
$2,500	$12,500	$5,000	$5,000	$25,000	10%

4. You can draw out 4%, rising in line with prices, from savings invested reasonably conservatively, with little chance you'll run out of money,and with your savings likely rising somewhat less than prices.

5. While you delay, these savings provide the higher income you'll get when you claim. See Steven Sass, "Should You Buy An Annuity from Social Security?" Center for Retirement Research Issue Brief 12-10.

6. Typical yearly expenses for a house worth $250,000:

Taxes	Insurance	Utilities	Upkeep	TOTAL	% of House Value
$3,125	$1,250	$1,250	$2,500	$8,125	3.25%

7. A reverse mortgage line of credit is typically much smaller than a conventional home equity line, with a higher interest rate and much higher up-front fees. But you don't need to repay what you draw as long as you live in the house. The line also rises over time, whether you use it or not, by the interest rate charged on funds you could draw out.

8. See Gerald C. Wagner. 2013. "The 6 Percent Rule." *Journal of Financial Planning* 26 (12): 46-54.

9. The lifetime payment option is not an annuity. The payments are loans and any home equity remaining after repaying these loans — when you move, die, or repay what you owe — belongs to you or your heirs.

10. Figures from the calculator on the U.S. Housing and Urban Development website, December 2013, at: http://rmc.ibisreverse.com/default_nrmla.aspx. Note: You might not get more if you wait as the value of your house could fall, interest rates could rise, or the program could change.

11. Origination fees are capped at $2,500 on a house worth $125,000 or less; at 2% of the value of a house worth $125,000 to $200,000; and $4,000 plus 1% of the value over $200,000, with a cap of $6,000.

12. Note: A reverse mortgage line of credit can be held as a reserve for nursing home care. Current rules also limit how much you can draw, so a significant amount of home equity should generally be available for nursing home care or bequests down the road.

Downsizing or a reverse mortgage can boost the income you'll have for the rest of your life to spend or save as you like.

Decision aids on our website

How to Get
Squared Away
in Retirement

Figure Out How to
Get Income from
Retirement Savings

Learn About
Behavior that Can
Ruin Retirement

Learn About
Using Your House
in Retirement

Figure Out
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