How to Use Your Home Equity in Retirement

by Midori Hillis

Perhaps you've been retired for a while, your estate plans are in order and you are comfortable with your retirement income, but there is something that keeps nagging at you, keeping you up at night. It's the gradual changes that are creeping up on you: increased living expenses are eroding your cash flow, and the marching of time has weathered your assets, your home, your car, your appliances and, not to mention, your physical health.

You find that your energy level and memory are just not what they used to be. The things you could look after in your 60s are not as easily done as you get older. Tasks like mowing the lawn, maintaining fencing or even meal preparation and housekeeping become much more of a chore to accomplish. You feel you should prepare for more support services, and their cost. Those are all real concerns, but the good news is that most Canadians will find significant value in their real estate that can be used to assist with their changing situation in retirement.

In this chapter, we will review some options for using your home equity to help you meet your lifestyle and financial needs. There are a variety of strategies to consider, including setting up a line of credit, using a reverse mortgage, downsizing your property or renting. We will explore these options now, as an overview, but before you commit to using your home as a resource, you should consult with a trusted financial advisor. They can walk you through the benefits and pitfalls of each strategy and how it would relate to your own personal retirement and estate plans.

Setting Up a Line of Credit

The most common way to access home equity is through a home equity line of credit (HELOC), also known as a secured line of credit (SLOC). In this scenario, you generally have access to 50 to 65 percent of your home's value and you pay interest only on what you borrow. You can use the line of credit to help pay the interest owing as long as there is room on the credit line to do so, which means you can use it with minimal effect to your retirement cash flow.

The bonus of a HELOC is that you can stay in your home longer and have additional funds. Dipping into your home equity can cover home-related and other costs, such as renovations to make your home more accessible, regular cleaners, yard maintenance services, meal services or nursing care. Keep in mind, once the balance owing increases to a point approaching the maximum, you will have to start looking at alternative options. The Canadian housing market is strong, so this could take years. Work with a financial advisor to estimate how long this option would last in your case.

Let's look at an example: Maggie and Will are 72 and 75 years old and have lived in their home for 30 years. They love the layout as well as hosting an annual Christmas dinner there for all the kids and grandkids. Although they have been struggling with the increased maintenance and the necessary chores, they are not ready to move and would like to stay in their home as long as possible. Maggie and Will have no debt, modest savings and their pension income is enough to meet their day-to-day needs. In order to make it easier to afford a few renovations and to hire help with some of the household chores, they are considering setting up a secured line of credit.

Their home is estimated to be worth $700,000, so, after discussions with a financial advisor, they decide to set up a line of credit for $350,000 and take out $2,000 per month ($24,000/year) to pay for a weekly house cleaner, monthly yard work, some prepared meals delivered and additional miscellaneous home repairs and maintenance, such as window and gutter-cleaning services. Setting up these support services will make living in their home much easier and more enjoyable.

Fast forward five years. At ages 77 and 80, Maggie and Will have used $24,000/year for five years for a total of $120,000; adding the cost of interest on the loan at 6 percent, about another $22,000, brings them to a total of $142,000 owing on their $350,000 line of credit, not even half of the total approved value. During that period, let's assume the market value of their house has increased by $70,000 (at 2 percent per year), putting the total value at approximately $770,000.

Lines of credit can be an easy way to access home equity; the downside is, floating interest rates can create higher interest costs, and unchecked spending and reaching your credit limit sooner than expected may force you into another situation. If that happens, you'll need to make another decision to cover your line of credit debt, such as selling and moving into a less expensive place; renting instead of buying; or setting up a reverse mortgage. Any outstanding balance on your line of credit can be paid off at any time and will be paid off fully when you sell or from the proceeds of your estate.

What About a Reverse Mortgage?

Like a secured line of credit, a reverse mortgage gives you access to the equity in your home (principal residence only), generally capped at around 50 percent of market value. A reverse mortgage is a loan, with a term such as three or five years, available to homeowners who are at least 55 years old. Any previous loans on your house would have to be paid off prior to getting a reverse mortgage. The main advantage to a reverse mortgage, unlike a secured line of credit, is that there is no obligation to make payments during the term of the loan. This option can be very helpful if you want to stay in your home longer without affecting your cash flow at all.

Interest rates are generally higher on reverse mortgages than on traditional mortgages. The terms of repayment are also stricter than line of credit terms, so I would suggest looking at this option only after you have considered and/or already used the line of credit solution. Reverse mortgages can work wonders and can be the right fit for those who want or need to stay in their home but can't afford to due to unforeseen family situations or health issues.

Let's look at Maggie and Will where we left off, at ages 77 and 80. Unfortunately, Will had a significant health event, a stroke, which left him in a wheelchair and unable to care for himself, and Maggie cannot manage his care on her own. Will is adamant that he still wants to stay at home and is not interested in moving to an assisted-living facility at this time. Home alterations need to be done for his plan to work: two ramps need to be installed, new beds are needed and a complete bathroom renovation needs doing. The estimated cost for these changes is $100,000. On top of this, additional nursing care is needed. Will gets three days a week covered by his provincial health care plan, so they decide to hire a nurse for an additional two days per week at $2,000 per month. After discussions with their financial advisor, they feel that the line of credit they set up five years ago is no longer adequate to meet their new expenses going forward, and they are looking into a reverse mortgage.

First, the secured line of credit will have to be paid off, so they will need a lump sum of $142,000 plus $100,000 for renovations with an additional $4,000 per month in income to cover their cash flow needs. The market value of their house is now $770,000. They choose a three-year term for the reverse mortgage, as their income needs may change again in that time frame. The interest rate of 8 percent is a little higher than on the line of credit, but the schedule is fixed and they know they can remain where they are and afford the additional expenses.

At the end of the three-year term, after the $386,000 loan paid out to them and another $100,000 in interest expenses and fees, there is approximately $325,000 left in home equity (including 2 percent annual growth in the value of the house). Thanks to their reverse mortgage, Will can live out his final days at home (including potluck Christmas dinners with the entire family) with the supports he and Maggie have come to rely on.

A Note about Property Tax Deferral

Many municipalities across the country have programs (generally starting at age 55) to defer your annual property taxes. It's useful to familiarize yourself with these programs when you are heading into retirement. You can plan on using the deferral for additional cash flow for your post-retirement needs. It involves a lien on your property, similar to a secured line of credit or reverse mortgage, so it is best to consider this program only *after* you have set up another home equity program. Otherwise, you may find yourself having to pay back the tax deferral first in order to access additional equity down the road.

Is It Time to Move and Downsize?

The first two strategies involve borrowing money from a financial institution, which means that you would be paying interest to access your home equity. Another way to use your home to assist your financial goals would simply be to downsize. Downsizing involves selling your current home and moving into one that is less expensive.

Perhaps you have outgrown your four-bedroom home and the maintenance that comes with it and you would like a smaller bungalow, condo or apartment. Once the move is complete, a smaller home will be easier to maintain; however, keep in mind how difficult moving can be after a lifetime of accumulation. Don't leave sorting through your belongings too late, as you will want time pack up and identify items you wish to keep and those you can donate, sell or recycle. Downsizing can also mean keeping a similar-sized house but in a different (less expensive) location.

Some families I work with decide to pool their resources and increase their savings by buying a new place with family members, usually children, with each having proportional ownership. This can be a nice option to help your family members get into the real estate market, as long as everyone can get along well living in a shared location. It is always a good idea to ensure that there is a written agreement or legal contract in place for shared expenses as well as what to do if one party decides to sell, such as granting the remaining party the first right of refusal to buy out the exiting co-owners.

Once you've moved to your new location, you may have a balance of funds left to invest. Working with your financial advisor to determine a suitable investment for your newly acquired home equity funds will ensure the best outcome for your personal objectives. It could be additional cash flow now or a higher savings balance for the future.

What About Renting?

Renting is an excellent way to forgo the responsibilities (and expense) of home maintenance and repair. This is also a great opportunity to downsize and purge your belongings, so you'll have a smaller home footprint to look after. Of course, you can still add support services as required, such as meal preparation, housekeeping and laundry. Sound good to you? It does to many other retirees as well!

Let's review where we left off with Maggie. She is now 80 and a widow and is ready to move out of her large family home. She can sell her house and use her remaining home equity of $325,000 to afford the monthly cost of an apartment close to her children. Luckily, her family helps her clear out, clean and list her current home; hire movers; and get her settled into her new location. Moving is a lot of work, but Maggie is happy to have an updated kitchen and a location close to her grandchildren.

She finds a nice apartment in a well-maintained building for $2,000 per month. Her pension income pays for her day-to-day needs, and she would need to withdraw $2,000 per month from her investments to cover the cost of her rent. Drawing $24,000 each year from her investments means her remaining savings will last around 15 years, bringing her financial independence.

What Is Right for You?

As you consider options for your evolving financial plans in retirement, remember that as a homeowner you can use your home equity to assist you in achieving your objectives. It may be as simple as setting up a secured line of credit or as complex as a reverse mortgage. These debt options both use the equity built up in your home over the years to provide the funds you may need; but be aware that they will eventually reduce the proceeds from the eventual sale of your home and potentially your estate value. Also, there are additional set-up and interest costs associated with these options.

There may come a time when you are ready for fewer responsibilities and increased daily support. You can accomplish this by downsizing, either by buying a smaller or less expensive home, or by renting. These options also would allow you to use some of your freed-up home equity to include costly support services in your monthly budget, such as housekeeping and meal services.

Any method of accessing your home equity to cover your retirement expenses will significantly decrease your net worth over time and, therefore, have a major impact on the value of your estate. This is not an issue if your estate wishes or obligations are minimal; but if there are certain bequests that are important to you to fulfill, it is best to work those into your overall plan from the beginning to ensure they get adequate funding.

Accessing your home's equity in retirement is becoming a much more common practice as real estate values stay high and the cost of living climbs. As a natural consequence, the number of ways you can access that equity has also increased, each with its own pros and cons. When it comes to accessing your home equity in retirement, there is no right or wrong solution, just what works for your personal circumstances. Having open conversations with your trusted financial advisor, preferably an independent Certified Financial Planner, and doing your research before selecting a specific option will help you make an informed decision for you and your family.

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Midori Hillis, BA, CFP® is a Senior Financial Advisor with IPC Securities Corporation who strives to make a positive difference in the lives of others by helping them plan for financial success. She is focused on listening to what matters most to her clients in order to guide them towards achieving their personal goals. Since starting in the industry in 2002, she has been building her own unique Personal Wealth Management Strategy™ to provide families with peace of mind.

Midori holds the designation of Certified Financial Planner from the Financial Planning Standards Council. She is securities licensed by the Canadian Securities Institute and has her life, accident and sickness license through the Insurance Council of BC. She has twice been awarded Investment Planning Counsel's Best Client Experience Award and is a proud member of Advocis, Canada's professional association of financial advisors, and has served on the local board.

Midori thoroughly enjoys calling Vancouver Island her home. She currently resides on a tranquil property in Willis Point with her family, her cats and her ducks. She gives back to her neighbourhood by organizing community events such as the spring swap meet and annual Christmas potluck, editing the local newsletter, arranging food drives, participating in "road cleanup" days and occasionally running the bar at the community hall for various events and fundraisers.

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