CHAPTER 1

Live Thirty Years on Your Home Equity

You can retire well on the equity in your home. This book will show you how.

Forgot to fund the 401k or individual retirement accounts (IRAs)? No problem. As long as you bought a house that appreciated substantially in value, you can look forward to a prosperous retirement. Do you have both a home and a substantial retirement portfolio? Even better. *Retire on the House* will show you how to best utilize your home equity to upgrade your retirement years and to pass on a larger bequest to your heirs. We will also show you how to protect yourself from a housing market decline and how to invest the proceeds of a home sale so that you never run out of money.

We have talked to many retirees who intentionally used their house as their sole retirement plan, and they are thriving in retirement. We will show you how to follow their lead.

Many new retirees have four times as much money in home equity as in stocks. Moreover, retirees are living longer. Advances in health care mean that the population aged 85+ will triple between 2010 and 2050. A long, successful retirement requires using home equity to the best advantage. This book shows you how to utilize your home equity for your entire retirement.

Whether intentional or not, for many Americans, home equity is already their retirement nest egg. According to estimates from the Federal Reserve, Fannie Mae, and Freddie Mac, the net worth Americans hold in their homes was $8.9 trillion dollars at the end of first quarter of 2005. This represented approximately $16.9 trillion in housing value less debt of $8.0 trillion.

In fact, residential real estate plays a significant role as the retirement nest egg for people all over the globe. We estimate that the global value of residential real estate was approximately $58 trillion at the end of 2004. Figure 1.1 shows the developed world asset allocation between residential housing, commercial property, equities, government, and corporate bonds. Residential property is an astounding 40 percent of the total $144 trillion in assets.

The 2003 State of the Nation's Housing Market Report prepared by Harvard University's Joint Center for Housing Studies stated home equity is now "the anchor of household wealth." According to the report, the 2001 median household net worth of homeowners totaled $172,000. This compares with a median net worth of renters totaling $4,810 during the same period. In addition, the bottom 20 percent of income-earning households had median net worth of $68,000 and for half that group, home equity represented 80 percent of household net worth.

Many more households own homes than own stocks. Sixty-eight percent of households own homes that have a $122,000 median value, while 52 percent hold stock portfolios with a median value of $34,000. Many of the stock portfolios are tied up in retirement plans. The Employee Benefits Research Institute reports that 34 percent of workers over the age of 54 have less than $50,000 of total savings. Clearly, most Americans will retire on home equity and not on stocks.

You 70 million baby boomers who are about to retire must use your home equity wisely to enjoy a successful 30-year retirement. The financial

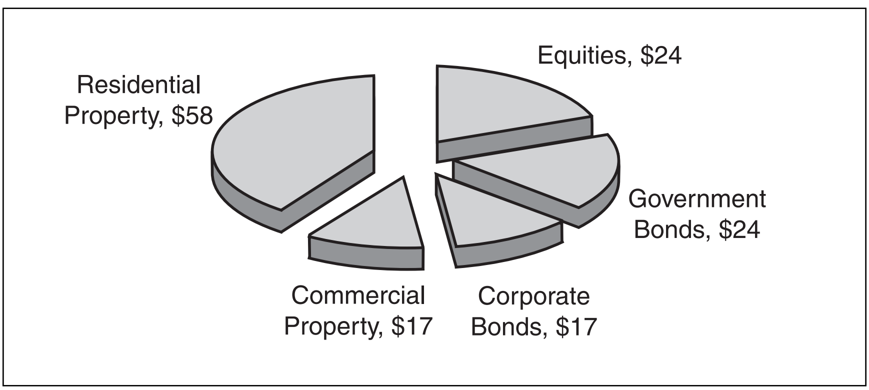

FIGURE 1.1 2004 Developed World Assets (in $ Trillions)

Sources: The Economist, MSCI, Standard & Poor's, our calculations.

industry has you worried that you have not saved enough. Stop worrying. Spent and invested wisely, your house may be enough savings.

MANY HOMES DURING A 30-YEAR RETIREMENT

Today new retirees are healthy and active. The old folks' home is the last place they want to spend their retirement years. The first decade of retirement is often spent doing all the things they missed out on earlier in life: travel; golf or tennis every day; going to the theater, opera, or museums; painting; drawing; singing; dancing; socializing without the children; grandparenting for the whole weekend; taking classes for fun and not to enhance the career; volunteering; even starting a new career or business; or just working the old job at an enjoyable, leisurely pace.

You need to have the right retirement home to match your retirement activities. For many retirees, your current home is well situated for the first decade of your retirement. However, you many not be able to afford to stay put for 10 years living on your Social Security, pensions, 401k, other savings, or part-time work. We will show you how to stay put by getting an income out of your house or by utilizing other options.

Some retirees will want to move to a resort community, a retirement community, or an urban high-rise close to recreation, cultural activities, children, or volunteer work. We will show you when to sell your current home, whether to buy or rent your next home, and how to invest the equity you freed up by selling the first home.

As you age in retirement, you may want to move to a home with no steps, railings in the shower, and security features. In the last stages of your retirement, proximity to medical care, family, and other support may be paramount. We will show you how to finance your final move to a retirement community, assisted living center, nursing home, or a continuing care center that offers many levels of assistance.

STUDY THE ENTIRE BOOK

We urge you to study the entire book before choosing an option. During the course of retirement, most of you will use more than one of the strategies we describe. It is important to study all the strategies and decide for yourself which option(s) best fit your particular needs. What you do first with your home equity can impact your next several options. For example, if you remodel the first home into units and bring in tenants, in some markets the house will later sell for a lower price than it would if it were left as a single-family home. You may also forfeit some or all of the $250,000 to $500,000 tax exemption on capital gains from the sale of a principal residence. Should you intend to sell at some point and move to Florida, you might want to rent the entire home for three years, and live locally in an inexpensive rental apartment rather than convert part of the property to units. Or alternatively, you might want to stay in the house more than three years so it can appreciate substantially, obtain a second mortgage or a reverse mortgage to increase your retirement income, then sell. The differences in your options will become clear as you study the rest of this book.

Many retirees will also own several homes during their retirement and they may use different strategies with each one. For example, you might want to cut a large family home into rental units, obtain a second mortgage on that large home, use the mortgage proceeds to buy your retirement home in Arizona for cash, and live on the income from the units. Later, you might want to obtain a reverse mortgage on the Arizona home until that home is sold at a substantial profit, move into an assisted living facility, and pay for the assisted living with the income from the units and the profits from the sale of the Arizona home.

NEVER RUN OUT OF MONEY DURING RETIREMENT

Retire on the House is for retiree homeowners who do not now have enough retirement income to continue to live in their current home or who anticipate income will be insufficient in later years. We will show you how to tap that home equity to create enough retirement income so you never run out of money. This book is also for more affluent retirees who own a home and have plenty of retirement income but want to put their home equity to its best use during retirement. These retirees would like to either use their equity to boost their retirement income or to ultimately pass on assets to children, charity, or other heirs. We also believe the financial advisor community can benefit from this book as a resource for their clients.

Each chapter that follows will help you determine what to do with your home equity now and in the future. Chapter 2 shows you how to project the future price of your home. This will help you determine if you want to sell and move on now, wait for a better future price, or hold on indefinitely. When looking to buy and then sell your next home, the process described in Chapter 2 will be utilized again to determine if, while you live there, the price of your next home will appreciate, stay where it is, or depreciate.

Chapter 3 shows you how to accurately appraise the value of your current home in hot and cold real estate markets. It then shows you how to estimate your home equity after subtracting mortgages, other liens, and selling expenses. Finally, the chapter will help you decide if remodeling and home improvements will increase the resale value of your home.

In Chapter 4 you learn how to increase your retirement income without moving. You are shown how to find and rent to boarders to bring in rental income.

Chapter 5 is about remodeling the home into units for much higher rental income.

Chapter 6 shows you how to remain in place without taking in tenants by substantially reducing your living expenses. Lower retirement expenses can dramatically increase your options if you have modest retirement income or a small or no retirement portfolio.

Chapter 7 discusses three options for obtaining cash from the home without selling, remodeling, or renting any part of the home: the reverse mortgage, the equity line of credit, and the interfamily loan or interfamily sale and leaseback. Links are provided to web sites where you can obtain reverse mortgages and equity lines of credit.

In Chapter 8 we show you your options for selling your current home and moving to a less expensive residence. These include:

- Buying a less expensive house, condo, or apartment for cash and investing the excess proceeds from the sale
- Buying a less expensive home with a down payment and mortgage and investing more excess proceeds
- Renting the next residence and investing all the proceeds of the home sale

Chapter 8 also demonstrates more ways in which reducing retirement expenses can increase your financial security.

Chapter 9 looks at selling your current home in order to buy into or contract with a retirement community with senior housing and/or assisted living and/or nursing care options. The chapter also discusses a move into your current second home or rental property in order to turn that property into a qualifying home for the $500,000 tax exemption.

Chapters 8, 9, and all the other chapters explain how you can reduce or eliminate taxes on all the alternatives shown in the various chapters.

A sale of the house, a refinancing, and the addition of tenants and income all allow you to build up a retirement investment portfolio. Chapter 10 shows you how to invest during retirement. The chapter explains that asset allocation is the key to successful investing during this time in your life. By owning multiple asset classes whose returns are both high and not fully correlated, retirees can avoid negative return years and still achieve relatively high overall returns. For retirees who retain substantial home equity, efficient portfolios can be constructed to effectively hedge housing price risk.

Once you fully understand the options you have for your home and the principals of investing during retirement, Chapter 11 presents examples that compare asset allocations so you can determine how to invest successfully for your entire life expectancy. There are also examples provided for retirees with smaller amounts of home equity to help address their dilemma.

RETIRE ON THE HOUSE CHECKLIST

As you consider what to do with your home or homes during the next 30 years, come back to the *Retire on the House* checklist below. (The checklist will be explained in detail by the end of the book.) This checklist will help you move from option to option and quickly see which options to eliminate and which to explore further.

RETIRE ON THE HOUSE CHECKLIST

1. Determine the current and future value of your house.
   a. Appraise the current value of your home (Chapter 3).
   b. Subtract mortgage debt and selling cost to determine current equity (Chapter 3).
   c. Estimate future appreciation by considering 16 factors that determine housing values (Chapter 2).
   d. Determine when to sell (Chapter 2).
   e. Make improvements to increase the resale value of the property (Chapter 3).

2. You cannot afford to stay in the house on your retirement income, but want to stay in the house. To obtain retirement income from the house, consider:
   a. Renting rooms informally to relatives or friends (Chapter 4).
   b. Renting rooms to tenants (Chapter 4).
   c. Converting part of the house to units and renting units (Chapter 5).
   d. Reducing spending so you can stay in the house without tenants (Chapter 6).

3. You want to stay in the house, but do not want tenants. Consider:
   a. Taking out a reverse mortgage (Chapter 7).
   b. Refinancing (Chapter 7).
   c. An interfamily loan, interfamily sale and leaseback, family partnership, or other family financing solution (Chapter 7).

4. You are ready to sell the house and use some or all of the net sales proceeds to increase your retirement income. Consider:
   a. Buying an inexpensive next home that will appreciate over time (Chapter 8).
      i. Buying the aforementioned home for cash and investing the excess sales proceeds (Chapter 8).
      ii. Buying the aforementioned home with a down payment and mortgage and investing a larger amount of excess sales proceeds (Chapter 8).
   b. Renting the next home and investing all the sales proceeds (Chapter 8).
   c. Moving into your preretirement second home or rental unit and investing all the sales proceeds (Chapter 9).
   d. Renting your current home for less than three years while you explore where you want to settle during retirement, then selling (Chapter 4).
   e. Selling and investing some or all of the proceeds in a long-term care retirement community (Chapter 9).
   f. Selling, investing all the proceeds, and renting space with fees in an assisted living facility, nursing home, or long-term care retirement community (Chapter 9).

5. By garnering a larger nest egg as the result of selling your home, refinancing, or saving retirement income, invest for high returns with low volatility (Chapters 10 and 11).

Now that we have reviewed what you will learn from this book, the first issue for all homeowners is to determine the current and potential future value of your home. This requires a thorough understanding of the housing market. The next chapter will show you how to make sense of the intricacies of housing price movements.