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Thinking About Your Home in Retirement

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When we do financial plans for families, we often don't include the home as an asset. The equity in the home is indeed real, but not necessarily useful. You have to live somewhere and will most likely either use your current equity towards a new home or need the cash flow from investing the equity (if you sell and rent) towards the cost of having a roof over your head.

We also tell families to have no mortgage debt upon retirement. This is avoid a large fixed expense, while drawing money from an investment portfolio. One of the safety valves in retirement should be the ability to tighten your belt on a variety of variable expenses (how often you eat out, what you spend on travel, fewer new cars, etc.). A home mortgage is fixed and needs to be paid even if your cash flow is impaired. Imagine another recession where both investment portfolios and real estate go down together at the same time. Imagine if the downturn took even longer. Having a mortgage to pay in such a time would be very painful.

As noted above, the home equity is something that can be used if needed. Not counting it in the financial plan as a useful asset allows a "buffer" in case things go poorly. If you need money during retirement and have a paid for house, there are several ways to obtain cash.

You can take out a home equity loan if the need for cash is likely to be short term. You can refinance and add a mortgage if the need is greater. You can process a reverse mortgage, in which the bank pays you either a lump sum and/or monthly payments, as long as you live in the home. If you change your mind with a reverse mortgage or the home is inherited, paying off the debt puts you back in control of the home and its remaining equity. For example, if you took $20,000 out in the first year of a reverse mortgage and then died, your heirs would get the home and its equity subject to a $20,000 loan.

Downsizing is yet another way to both lower retirement expenses and mobilize some cash. Surprisingly, I don't see that happening much with retirees, as they either stay put or move to a similarly priced home elsewhere. One mistake I do see from time to time is spending more money on housing during retirement when the family's savings are not adequate to do so.

If you are entering retirement, give this some thought and discuss it with your advisor.

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