

Financially Speaking
With Trisha Arndt, CFP®

Keys to Unlocking Home Equity

Over the last few weeks I've developed a habit of going for a walk around lunch time whenever the weather allows. The fresh air and (occasional) sunshine is good for me and it helps me to clear my head and refocus for the afternoon.

I've taken to wandering around the streets of Verona and checking out the different residential neighborhoods. Recently I noticed a couple of for sale signs in an area that I know is populated with very long term residents and I found myself musing about what the motivation was for those people selling. Had they reached a point where they no longer wanted or were able to take care of the maintenance? Or was the sale financially motivated and, if so, had they researched other options for tapping their home equity?

The events of the last couple of years have caused many people to rethink their financial strategies and for a number of retirees the damage the bear market caused on their portfolios has put them in a position where they need to reevaluate whether they have enough money to provide the income they want. For those who find that changes may be necessary the three most common options considered are significantly adjusting their spending, going back into the work force or drawing on equity in their home.

Traditionally people would access the equity in their home by selling it – either to downsize to owning something different or to convert to renting (or some other living arrangement). For many that it still the preferable option – home ownership brings with it a lot of costs like property taxes and repairs as well as the work entailed with maintaining the home and grounds – and who really likes to shovel snow when its 20 degrees below zero? Many people reach a point in their life where they no longer want those responsibilities and they simply sell the home and move to somewhere that poses less physical and/or financial burden.

But for others the thought of moving from the house that has been their family home is more than they can bear. While there may be responsibilities tied to staying, for some the alternative of selling the place where they raised their family is not worth considering.

For those that want to stay in their home but need to access some of the equity they have accumulated there may be options for borrowing against it.

The most basic way to do so is through a traditional home equity loan. Most financial institutions offer home equity loans which can be in the form of a lump sum of money or access to a line of credit. In either case the loan is collateralized by the equity in the house and some amount of monthly payment to the institution will be required. They are generally fairly inexpensive to set up however the current lending environment has

certainly affected underwriting rules. Among other considerations, there will almost certainly be a need to prove that you have the income to make the monthly payments.

An option that has been rapidly gaining popularity over the last decade is the reverse mortgage. A reverse mortgage is similar to a home equity loan in that it borrows against the equity in the home, but there are a number of key differences. They are available only to people age 62 and older and the amount you can borrow depends on your age, the value of the home and current interest rates. You can choose to receive the money in a lump sum, line of credit or in the form of monthly installment payments – a reverse “mortgage” payment to you from the lending institution (hence the origin of the name).

Rather than requiring systematic repayment like a traditional loan, reverse mortgages are paid back when you move out of your house, sell it or die. If there is money left over from the sales proceeds it goes to you or your heirs. And if the loan turns out to be bigger than what the house sells for, you (or your estate) are not responsible for paying back the difference.

So far the reverse mortgage sounds like a pretty sweet deal. But you know that it can't be that simple, and it isn't.

Reverse mortgages turn out to be a rather expensive way to borrow. The loan balance is charged interest just like a traditional loan but that interest just keeps accumulating – and being charged more interest – until the loan is paid off. There are also a significant amount of up front charges – far more than a traditional mortgage or home equity loan. Legislation passed last year did put in some caps but it is still important to understand all of the costs involved before deciding on this option. The AARP has a lot of useful, easy to understand information about reverse mortgages within the money section of their website, www.aarp.org. It is a good place to start researching if you think this is an option you may want to consider.

Regardless of how you would decide to access your home equity it is important to understand the options if it is something you are contemplating. Take the time to do your research and pick the option that appeals most to you.

Have a question that I could answer in a future column? Please email it to me at trisha@wealthstrategies.biz.

Trisha Arndt, CFP[®], is president of Wealth Strategies of Wisconsin Ltd, 535 Half Mile Road, Ste 5B, Verona, 848-2400. Securities and Investment Advisory Services offered through Commonwealth Financial Network, member FINRA/SIPC, a registered investment adviser. Wealth Strategies of Wisconsin Ltd and Commonwealth Financial Network are separate and unrelated entities.