Releasing capital from the family home

As the population ages, there may be a need to look to the family home to release capital. It is an emotive topic, and one that should be considered carefully.

There are many reasons why releasing capital from the family home might be considered in the first place. Depending on where you live, it could be to take advantage of currently high property prices, or because the stock markets aren't providing the sort of returns required for long-term retirement planning. Australia has an ageing population combined with longevity increasing, and there are concerns about future welfare or how the family home as an asset will be assessed in the future. There is also the option to allocate money released from downsizing into your superannuation account.

Beyond that, there are other factors that may come into play, including the need to fund living expenses, or to help enter aged care. There is retaining the asset for future generations through advance inheritance and helping children get a leg up. It could be the need to meet medical costs, or maybe avoiding a potential increase in the number of properties on the market as the Baby Boomers release their capital from homes.

Whatever the blend of reasons for considering this capital release, there are a number of options available, and here we'll examine two — downsizing, and a reverse mortgage.

Downsizing

Downsizing is the selling of the family home, and purchasing one for a lesser value and using the balance to either deploy in investment strategies to provide returns, or as cashflow. This approach leaves the access to equity entirely within your control — it becomes a 'choose your own adventure'.

There are things to consider beyond the obvious financial aspects. There is the potential loss of community involvement if you need to move away from your local area. There is also the transaction cost – including agent fees, and stamp duty. Finally, the transaction will almost

certainly impact your ability to qualify for some or all of the Aged Pension.

Moving into a retirement home may be an option based on value but the area is unregulated to caution must be exercised.

Reverse mortgage

Historically — if you go back 10 years or longer to when reverse mortgages first appeared — there was very little consumer protection, so the bank had the ability to lend you a far greater amount of money than they can today and banks could proceed to foreclose a property if it believed it could lose on the loan. By and large, if you mention the concept of reverse mortgages or equity release to most
Australians you would get a negative reply. There have been multiple changes to the reverse mortgage market today that protect consumers more.

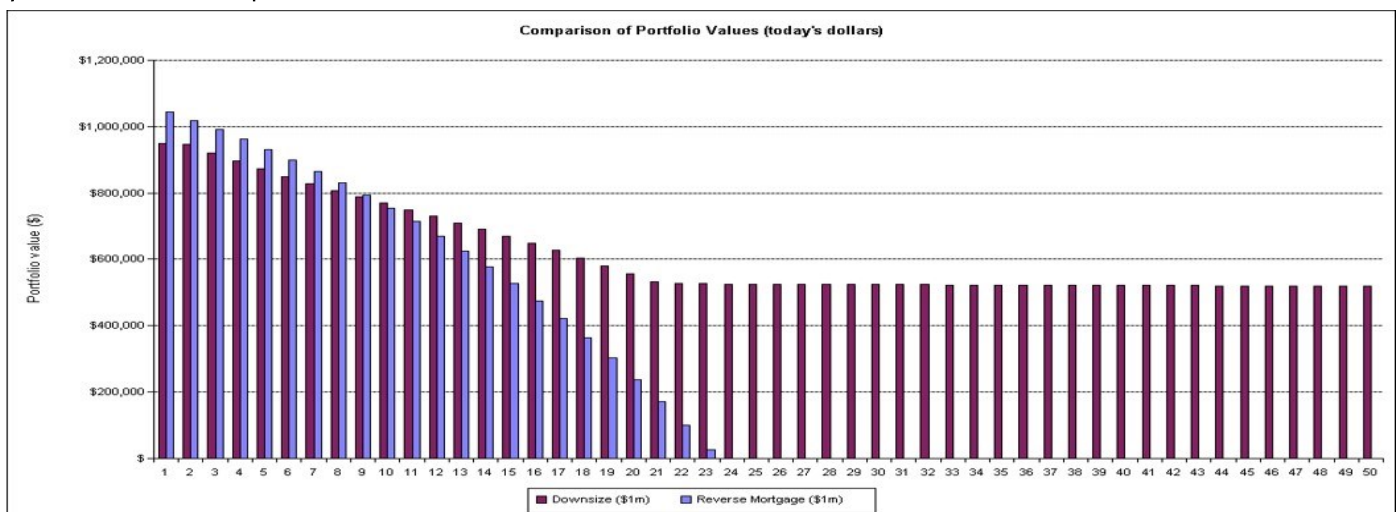
A reverse mortgage is a loan from the bank against the assessed value of the home at the time of application. The total that can be borrowed depends on the age of the applicant — someone at 60 years of age can borrow around 15% of the home's value; someone at 75 could borrow in the region of 30 per cent. The amount you can access depends on the valuation at the time of application, so if you return to the bank when you hit the next age bracket, your new borrowing capacity is based on a new home valuation.

A reverse mortgage gives a level of access that leaves the home owners with no potential to be exposed to negative equity — at no point will the bank have a claim for more than the value of the property, and during your lifetime the bank has no power to repossess. It does, however, expose you to interest rate susceptibility, and there is also the risk that property valuations fall, both of which will limit the potential of future credit extensions.

When the person who has taken the loan from the bank passes away, the remaining family members have the option to repay the bank without the asset needing to be disposed of.

Scenarios

The following chart illustrates the impact of downsizing and a reverse mortgage on the total capital available to someone over the ensuing 30+ years. It assumes the investment of half the home value into a 50/50 portfolio after the sale of the home.



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We've elected to model based on only 50 per cent of investment in growth because after downsizing, you're not going to bet the kitchen sink on the markets.

For a single person in a $1m property (and the impact will be greater for a single person than a couple), the downsizing removes about $60,000 in costs from the get-go and it also affects the Aged Pension entitlement.

From a net asset perspective — what is my estate worth if I pass away at this point? — the two options meet at about 10 years. However, the reverse mortgage really starts to bite after 10 years as the compounding interest on interest kicks in and the value of the estate starts to fall away quickly after this point.

Conclusions, and actions

The most important aspect to this sort of financial transaction is to be absolutely clear on what the objective is. Once the objective is known, the decision will be clearer. Both the options can be viable solutions based on the required objective.

The comparisons in the chart will vary depending on personal circumstances. It is also a big decision, so make sure that you've enlisted the help of an adviser before you make such a big financial decision, especially with the family home.

This article was based on a Sentinel Wealth lunchtime briefing hosted by Adam Faulkner.