

## Best ways to tap into home equity to fund retirement

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High transaction costs in trading property can chew up over 20 per cent of the gross surplus.

by Richard Wakelin

Are you one of the 55 per cent of over-55 homeowners identified by the ABS as mortgage free? If so, you are undoubtedly the envy of much of the rest of the population, some of whom think you have it easy.

But it's not all cruises and croissants for this cohort. Many are grappling with the transition to retirement which is coming at them fast. And while a lack of a mortgage is usually a necessary staging post for retirement security, it isn't always enough.

The compulsory superannuation system introduced in 1992 has only been around for half the working lives of older Australians. So many are trying to sock away substantial amounts of disposable income into a fund now [despite lower super contribution caps](#).

Ideally, those recently deposited funds will remain in the super fund for another 20 years so that the [magic of compound growth](#) can be reaped, ensuring a comfortable lifestyle when the individual is, hopefully, in their 70s and 80s.

But what about the early years of retirement – say from 65 to the early 70s? How will that be funded without eroding the super pot that is needed for the later years?

This is where the downsizing of the home often comes into play.

### High transaction costs

With the kids usually in their twenties, the family-rearing home can be exchanged for a smaller place, and hopefully release several hundred thousand dollars in the process. But [this strategy often delivers fewer dollars than expected](#), not least because the high transaction costs in trading property can chew up over 20 per cent of the gross surplus.

There are two routes that avoid these transaction costs and might appeal to the home owner who doesn't want to downsize.

The first – known as a reverse mortgage – is debt-based. The second – equity release – involves selling a share of the home to a bank.

In each case, the bank or other financial services organisation delivers cash to the homeowner in return for its secured debt or equity share. The payment from the bank may either be a lump sum or drawn down as needed. The bank's payday occurs when the home is eventually sold and the debt is cleared or it receives its share of the sale receipts.

For reverse mortgages, the good news is that there is a legal safeguard from falling into negative equity. The customer can never owe more than the equity in their home. The bad news is the interest rate for reverse mortgages tends to be around 1.5 per cent higher than the standard rate paid by conventional mortgage holders. By contrast, the equity release customer isn't paying any interest.

### Best options

What's the best option for the Babyboomer: downsizing, reverse mortgage or equity release?

Clearly, every person's scenario is different and it is therefore vital to obtain independent financial advice. But, in general terms, the answer is it depends on the future capital growth of your home relative to either interest rates or the capital growth of the replacement property.

If your home was to deliver a capital growth rate in coming years that is higher than a reverse mortgage rate, then you would be ahead if you chose the reverse mortgage over the equity release product.

Similarly, for downsizers if the capital growth on the replacement property turns out to be poorer than the original property, then they might have been better off keeping the original home and buying a reverse mortgage or equity release product instead.

Of course, the future cannot be predicted, but a good financial adviser will help you weigh up the balance of probabilities.

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AFR Contributor

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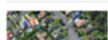
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