Mar 24 2017 at 11:00 PM | Updated Mar 24 2017 at 11:00 PM

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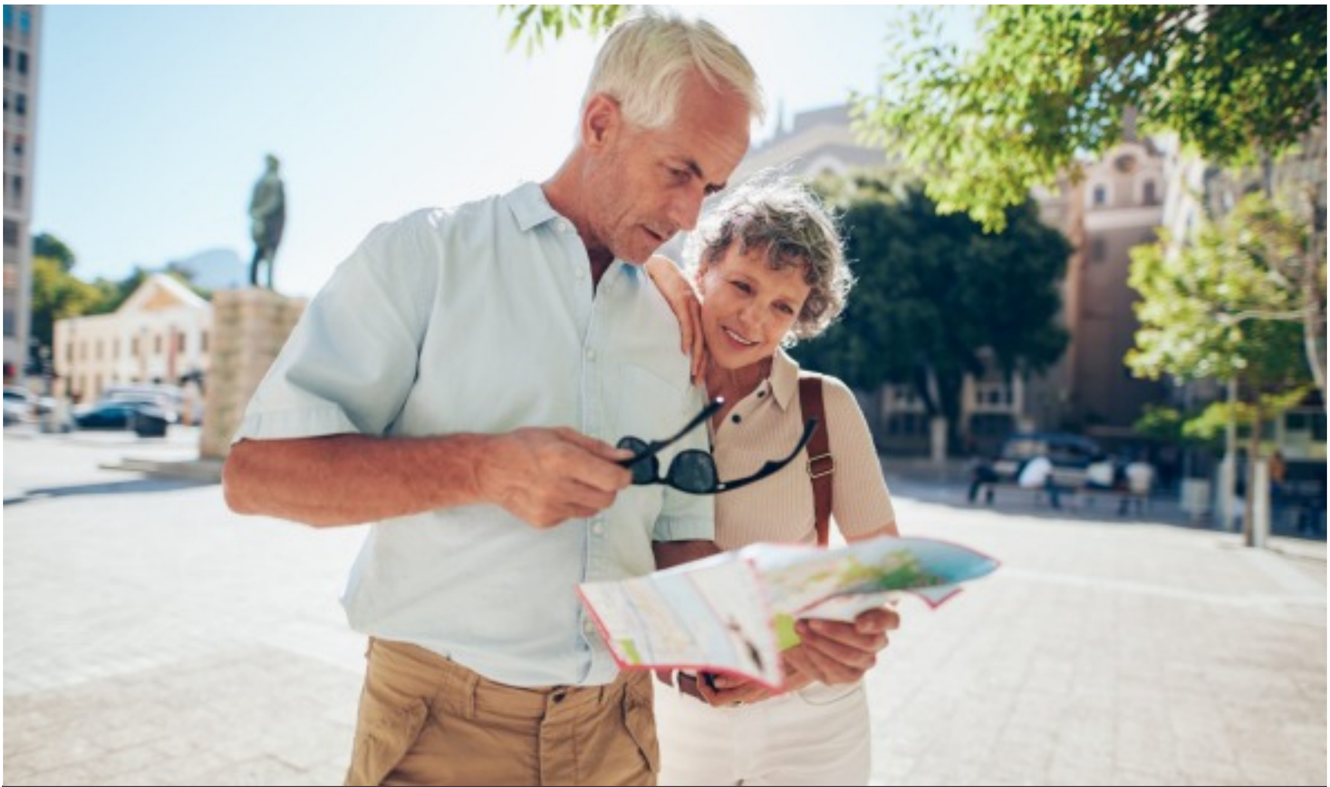
How your home can finance your retirement



Retirees are borrowing higher amounts for a better lifestyle in retirement by accessing the equity in their homes. **Getty Images**

by **Bina Brown** Soaring property prices, the new pension rules and the desire to lead an active, comfortable retirement are driving demand for equity release solutions.

Whether it is a reverse mortgage, home reversion scheme or aged care loan, the family home can be a handy source of cash.

With a reverse mortgage, borrowers use the equity in their home as security for a loan that can be taken as a lump sum, a regular income stream, a line of credit or a combination of these options.

With home reversion, a lump sum payment is paid by the provider in exchange for a fixed proportion of the future value of a person's home.

Dipping into the family home

Comparison of equity release products

Company	Product	Advertised interest rate (%)	Max LVR available for 65 year old (%)	Combination of lump sum/ disbursements allowed	Executor can pay debt to keep the property	Property allowed for rent	Redraw facility
REVERSE MORTGAGES							
Bankwest	Seniors Equity Release	6.20	25	No	Yes	Yes	Yes
Commonwealth Bank	Equity Unlock Loan	6.37	20	Yes	Yes	No	Yes
Heartland Seniors Finance	Reverse Mortage	6.19	20	Yes	Yes	Yes	No
Macquarie Bank	Reverse Mortgage	6.20	20*	Yes	Yes	Yes	Yes
P&N Bank	Easy Living Access Loan	6.24	20	No	Yes	No	Yes
St George/Bank SA		6.22	20	Yes	Yes	Yes	Yes
Bank of Melbourne		6.20	15	Yes	Yes	Yes	Yes
AGED CARE LOANS							
LaTrobe Financial	Aged Care Loan	5.60	50*	Yes	Yes	Yes	No
Heartland	Aged Care Option	6.19	45	Yes	Yes	Yes	No
Macquarie Bank	Accommodation Bond Ln	6.20	45	Yes	Yes	Yes	No

* based on 70 year old * below 80 year old on application

SOURCE: CANSTAR; REVERSE MORTGAGE FINANCE SOLUTIONS, FINANCIAL REVIEW

The more recently developed aged care loan is specifically to fund the payment of the refundable accommodation deposit for entry into residential aged care which can be anywhere between $300,000 and $1 million.

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Reverse Mortgage Finance Solutions credit adviser Paul Dwyer credit adviser Paul Dwyer says most preferred products have the option of a lump sum and or a regular drawdown.

"The flexibility in retirement is important as circumstances change. People may start with a lump sum for repairs and maintenance or a new car but then they like the option of a cash reserve or a line of credit to top up their retirement income," he says.

Dwyer says while most lenders will be able to achieve the funding needs of Australian retirees (average loan amounts are around $95,000) Macquarie and Heartland can fund up to $1 million with another potential lender looking to go higher.

Dwyer is seeing wealthy retirees borrowing more to sustain their lifestyle in retirement.

He says these higher loan amounts are driven by borrowers who have been successful in their business lives and built up a significant asset in6 owner-occupied property. But with diminished retirement investments, they want to access equity for lifestyle needs.

Happily, for retirees living in Melbourne and Sydney in particular, surging house prices mean they are able to borrow more against their homes.

Dwyer says most of the 40,000 users of reverse mortgages are on a pension or part pension.

On that score, the tightening of the means testing for the age pension, which took effect in January, is expected to trigger a rise in demand for such products.

Under the new regime, the upper threshold for a couple who own their own home to receive a part pension is $816,000, down from $1.2 million. For a single homeowner, the threshold is $542,000, down from $794,000. An estimated 326,000 people lost the part or full age pension as a result.

Furthermore, changes in the so-called taper rate mean that an individual's pension is reduced by $3 per fortnight, or $78 a year, for each extra $1,000 in assessable assets. Until last year, the amount of pension fell by $1.50 for each extra $1000 of assets. Combined the changes have meant a significant reduction on the income many part pensioners receive from the public purse.

"With increasing costs of living, many borrowers, including full age pension recipients, are looking to increase their income with small regular drawdowns, often no more than $400-$500 per month. Even more evident is the increase in enquiries from retirees who have lost most or all of their previous pension entitlements with the new assets thresholds as of January 1 this year," says Dwyer.

Reverse mortgages do not generally affect Centrelink entitlements and there are some interesting cases where borrowers have been able to use a reverse mortgage without impacting pension benefits, Dwyer says.

He cites the case of a Melbourne couple who, having used most of their $700,000 superannuation to complete the purchase of a new home valued at $2.9 million, then became eligible for the full age pension and obtained $60,000 equity release per year to meet their cost of living.

Reverse mortgages

With a reverse mortgage no interest is payable until you move out of your home or sell it. However, the interest compounds over time, adding to your loan balance.

If the house value increases, then the loan can be repaid with little impact on the net equity. If the house value decreases, you can never owe more than a certain percentage of the value of your home and the bank cannot require you to repay more than the value of your home.

Let's look at how a reverse mortgage works for Frank and Ana*, both 80, who own a house valued at $2.5 million and a $300,000 share portfolio. The couple needs Sydney $80,000 of income for the next five years. They have a part pension of $16,000 a year and receive dividend income of $16,000 a year. So they need another $48,000 a year.

Rather than sell shares with franking credit dividends to maintain their lifestyle, they take out a $400,000 reverse mortgage loan (interest rate of 6.2 per cent), including a monthly drawdown and a cash reserve.

Through the reverse mortgage they access $4000 a month while their home appreciates at four per cent a year.

At the end of five years, they enter aged care and sell the house. The interest amounts to $40,691, plus $240,000 in payments and $475 in establishment costs. The total of $281,166 is repaid from the sale value of the house ($3,041,632), leaving $2,760,466.

Generally a reverse mortgage is repaid when a property is sold, upon death of the last borrower or if the borrower moves out for more than 12 months such as into aged care or with family, Dwyer says.

Dwyer says that where a reverse mortgage is taken out, one option may be for the family to pay some of the interest to minimise the impact over the longer term.

Home reversion

Bendigo Bank-backed Homesafe Solutions offers a shared equity or home reversion solution, where eligible home owners sell a share of the future sale value of their home.

Depending on your age and the value of your home today, Homesafe will provide a lump sum cash amount upfront of anywhere between $250,000 and $1 million – which is an amount based on the future share you wish to sell.

Homesafe then becomes entitled to the agreed percentage of the future sale proceeds of your home – whenever that might be.

It is generally only available to home owners in metropolitan Sydney or Melbourne.

Homesafe managing director Peter Szabo says the Homesafe solution may be an option for seniors who have lost or had pensions reduced due to the new assets test.

"Funds can be used to replace lost pension entitlements, avoid the need to downsize and [help people] continue to live in the family home with dignity and financial security," he says.

To use the government's Moneysmart example: If a home is valued at $200,000 and you sell 50 per cent of the future value of your home you will receive a discounted sum that might range from $35,000-$65,000, depending on your age.

You don't have to make repayments on the money you receive while you live in your home. When your house is sold, you have to give a portion of the proceeds to the scheme provider. So, if 20 years down the track your house sells for $400,000, the provider would get 50 per cent of this amount or $200,000.

Aged care loans

La Trobe Financial's Aged Care Loan is specifically designed to fund the payment of the RAD for entry into residential aged care rather than sell the family home. It is a seven-year variable rate loan available to people over 80 who can access up to 50 per cent of the value of their home or a maximum $750,000.

Interest payments are not due until the total loan balance increases to 140 per cent of the initial settlement amount — generally about five years into the loan.

When the borrower leaves the facility, the RAD is refunded back to La Trobe Financial, the borrower or the estate pays any accrued interest and the mortgage is released debt-free.

La Trobe Financial vice president Martin Barry says there have been hundreds of enquiries since the product's launch in January 2016, with the average loan being about $400,000.

Customers are generally pay the full RAD to improve their cashflow position knowing no further daily fees are payable for their room. there is the option of using the loan to pay a part RAD, part DAP (daily accommodation payment).

Barry says surviving family members who want to keep the home after the borrower passes away may use other assets in the estate to pay out the loan.

An added bonus if the house was vacated for someone to go into care and is not rented out is that it may be sold without incurring capital gains tax for up to six years after the owners left the property.

Barry says that with the average stay in aged care about two to three years, most people using an aged care loan to pay their accommodation costs are happy to have the interest accrue. That way it's up to their surviving family members to pay later if they want to keep the home or sell it and pay out the loan. With the RAD repaying the loan principal, the risk of eroding significant property equity is low.

Let's look at an example. If George* needed to go into care, had a $1.5 million home and took out an aged care loan of $600,000 to pay the RAD, after five years the interest owing would be $240,000 (at current interest rates). Upon death, the RAD would be fully refundable to La Trobe Financial and, once the interest was repaid, the property would be mortgage-free.

New lenders

Dwyer says an advantage of reverse mortgages over other equity release products (such as home reversion schemes and aged care loans) is borrowers can make regular withdrawals tailored to their needs, thus minimising the end debt against the security. The more expensive alternative with a reverse mortgage is to take a lump sum.

With a slightly lower interest rate, an aged care loan is a potentially cheaper alternative (see table).

Dwyer says a regular drawdown on an aged care loan to pay aged care costs at an interest rate of 5.6 per cent can be considered a good trade-off against selling the family home, a loss of capital growth and an increased means-tested care fee. By contrast, interest rates on reverse mortgages are higher than 6 per cent.

At 5.6 per cent the interest rate on a La Trobe Financial Aged Care Loan is less than the government's maximum permissible interest rate of 5.76 per cent (rising to 5.78% on 1 April) that a facility can charge on the unpaid portion of a refundable accommodation deposit (RAD), making it a viable alternative to paying all or part of the daily accommodation payment (DAP). (Those unable to pay the RAD in full have to pay this daily fee, basically interest on the unpaid deposit).

Deloitte financial services partner James Hickey says the current marketing of equity release products are also being influenced by rising property prices, low interest rates and volatile financial markets impacting people's retirement savings.

With interest rates so low, the margins are slim for reverse mortgage lenders, the number of which has more than halved over the last 10 years. Current leaders include CBA, Bankwest, St. George, Bank of Melbourne, Bank SA, Macquarie Bank and Heartland. Member-owned P&N Bank offers a reverse mortgage in West Australia.

However, shared equity and aged care loans will do well out of strong property prices, says Hickey.

Industry sources say new lenders are preparing to add reverse mortgages to their product range, with interest rates and fees lower than existing products.

*Fictional examples

Bina Brown is a director of aged care solutions company Third Age Matters.

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