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Unlocking home equity

Many properties have increased in value over the past few years. Market appreciation as well as mortgage paydowns have improved owners' equity, leading some homeowners to feel "house rich. However, homeowners with valuable homes sometimes experience cash flow constraints, mainly due to higher costs. Expenses that are driven by inflation are significant, including maintenance on homes and utilities, childcare, elder care, private school, and college tuition, supporting young adults after graduation, and medical expenses. Homeowners who are experiencing cash flow constraints but have valuable properties might feel "house rich but cash flow challenged."

There are various liquidity solutions for those who wish to unlock some equity from their home. One option is to downsize; it's not for everyone, but some don't need the space anymore, especially empty nesters. Downsizing is a good option for those who prefer not to take on more debt.

Another option for liquidity is a home equity loan, and there are two basic varieties. A second mortgage allows a homeowner to borrow up to 80% of the value of the home's value. Second mortgages are considered riskier than primary mortgages since they are second-position loans and are priced accordingly. The average 30-year fixed-rate mortgage as of November 2023 is hovering around 8%. In contrast, the average second mortgage rate is between 9-12%. While second mortgage rates are higher than primary mortgage rates, they are lower than credit card and personal loan rates.

The other type of home equity loan is a HELOC. The borrower may draw funds from a HELOC when needed, and it is like a credit card with much lower rates. These loans typically have variable interest rates, but some lenders offer fixed rates. Principal payments are optional for the first 10 years, this is known as the draw period. After this time, the outstanding balance will typically convert into a principal-plus-interest loan for a 20-year repayment period. The current average HELOC rate is hovering around 9%. HELOC interest payments are currently deductible if used for home improvements.

Another liquidity option for those aged 62 and older is a reverse mortgage. Historically, reverse mortgages have earned a bad reputation. Today, there is more regulation, and the federal government has put guardrails on these types of loans. However, one should still proceed with caution when considering a reverse mortgage. For some, it is a great way to free up some liquidity. and for others it may be a last option. Fees can be high and there may be other restrictions, such as the inability to rent or Air BnB the property. A homeowner might use a reverse mortgage for several purposes, including liquidity, wealth transfer, or Medicaid planning.

The goal of a traditional mortgage is to pay down the balance over time. The opposite is true of a reverse mortgage, whose balance increases over time because no payments are made. The mortgage is not due until the property is sold, typically when the borrower moves out or passes away. Borrowers can elect to receive monthly income, a lump sum payment, or draw payments as needed. The borrower must continue to pay property taxes and insurance. Failure to do so may cause the lender to force payments or call the entire loan. If the borrower sells the property, pays off the reverse mortgage, and there is still value left over because the home has appreciated, the borrower keeps the appreciation. Note that taking out a reverse mortgage does not impact your credit score.

For those who are seeking to purchase a new home and have an investment portfolio but lack income, there are several types of non-traditional mortgage products. One example is an asset depletion loan which uses an algorithm that takes into consideration age and what types of assets the borrower owns to determine "qualifying income". The qualifying income is then used to determine how much the applicant may borrow. Asset depletion loans are issued by a variety of lenders, including private lenders, Fannie Mae, and Freddie Mac.

Independent of home ownership there are other sources of liquidity including intra-family loans, lines of credit on marketable securities portfolios, and personal loans from banks. Usually, homeowners will lean towards the least expensive financing option, but they may need assistance understanding how it will affect their overall wealth plan. Please reach out to your Wealth Manger with questions about unlocking equity from your home or other liquidity options. heir plan.

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