

Retirees: Consider Downsizing

By Marilyn Kennedy Melia, Special to the Tribune

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More money, lower living costs, fewer maintenance hassles. This is the tantalizing prescription for simpler living many experts have expected retirees to widely embrace. Downsizing. It's a term that has worked its way into the common parlance to describe the act of moving from an expensive home to a less costly, often smaller one. And, the word is also used more generally to illustrate a more unencumbered lifestyle.

Though downsizing can offer financial and lifestyle benefits, the concept is probably not attracting enough retirees, says Brent Kessel, a certified financial planner and president of Abacus Wealth Management, Pacific Palisades, Calif.

"We don't have any systematic data on how many people are downsizing," says Alicia Munnell, director of the Center for Retirement Research at Boston College. But she, like Kessel, says that a number of factors have converged to make downsizing an option worth more serious consideration by retirees and pre-retirees.

The ability to take profits from a home sale is one way downsizing can be economical. But it also may offer opportunities to cut everyday expenses such as utility costs and property taxes. A recent issue of the AARP magazine contained a checklist of points to consider in making a downsizing decision. For instance, if housing costs top 35 percent of your income or if you have a large yard you don't use, you may be a candidate for downsizing.

"Many retirees really don't have a lot of options," Munnell says. Only a minority of people make a deliberate decision to downsize, says Olivia S. Mitchell, executive director of the Boettner Center for Pensions and Retirement Security at the Wharton School at the University of Pennsylvania. Rather, moves are more often motivated by "a shock, like the death of a spouse," she says.

But, today, financial factors may be a more powerful motivator, Munnell says. Reverse mortgages and traditional home-equity loans allow seniors to obtain money based on the value of their home. But, Kessel points out, "Some people are living in a home that's just too expensive to maintain and an equity loan won't help them cut their costs."

Kessel says he runs data on clients' spending habits and their assets and income stream through a software program that analyzes whether they will have enough money throughout their expected lifespan. "Sometimes it turns out that if they stay in their house and keep spending the same way, they'll run out of money. So, then, we look at

alternative scenarios involving downsizing."

If you decide to move, the next step is to analyze carefully the costs of living in a new location. "You have to do research on what property taxes, utilities and other items will cost," Kessel says. Further complicating the decision, he says, is whether all the profits from a home sale should be used to buy a new place, or whether the retiree should invest the proceeds and take a mortgage on the downsized home.

As a general rule, Kessel says, retirees who are willing to choose investments that yield more than the after-tax cost of mortgage interest should borrow to buy their next home. For instance, if retirees are in a 22 percent tax bracket and they can get a 6 percent mortgage, the real after-tax cost of that interest is 4.68 percent, says Kessel, because they can deduct the amount of mortgage interest they pay from their gross income (figured by taking 22 percent of 6, or 1.32, and subtracting that from 6 percent). They would then need to find investments yielding more than 4.68 percent to make borrowing worthwhile, Kessel explains.

"Some retirees feel comfortable investing only in very conservative investments like Treasury bills that don't have high yields," he says. Those conservative-minded investors should probably use the proceeds from their home sale to buy their new home, while more aggressive investors who feel confident they can earn returns greater than 4.68 percent would take a mortgage and invest their home sale profits, Kessel says.

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