Sale-Leasebacks for House-Rich Americans

Millions of elderly Americans are "house-rich" but "cash-poor." That is, they live in valuable homes but don't have enough *money* for everyday expenses. Often, their adult children cover some of their expenses, an experience that can be demoralizing for the parents and uncomfortable for the children. This need not be the case. There are innovative ways in which today's elderly can take advantage of the equity in their homes without jeopardizing the roof over their heads.

Keeping the Home in the Family

With a **sale-leaseback arrangement**, you would buy your parents' house and lease it back to them for life. If your parents are age 55 or older, they won't have to pay federal income tax on profits from the sale, up to $125,000. Therefore, the house stays in the family and helps relieve anxiety about the future. If your total income is less than $150,000, ownership of the house provides all the benefits of rental property, deductions for interest expense, property taxes, depreciation, and maintenance costs. Further down the road, you may also profit if there is appreciation in the market value of the house.

For example, let’s assume Ms. Q has parents with limited income but who own a $100,000 house free and clear. Ms. Q can buy her parents’ house with a $10,000 down payment. Her parents finance the rest of the amount by providing a $90,000 ten-year amortizing mortgage at 10% interest. As part of the arrangement, her parents sign a lease granting them the right to rent the house for as long as they live.

During the term of the agreement, mortgage payments of $1,190 per month to Ms. Q’s parents should enable them to pay the rent and even leave them with extra cash for expenses. With the proceeds from the down payment, they could buy a **deferred annuity** that would begin payment in ten years when mortgage payments to the parents are terminated and would provide them with supplementary income for life. Even though sale-leasebacks are a family affair, they are not simple to arrange. These complex transactions require a legal professional who has experience with real estate sales and rentals, as well as **mortgage annuity contracts**. In addition, for an individual to reap any tax benefits, the IRS requires that parents be charged rent that is comparable to similar houses in the neighborhood.

Sale-leasebacks can have drawbacks as well as benefits. The loss of home ownership may affect the status of a parent if, for example, one of them is ever in need of entering a nursing home. That is because a house is an **exempt asset** when applying for medical coverage while the note receivable is nonexempt.

Reverse Mortgages Provide Monthly Payments

It may also be worth considering a **reverse mortgage**, a popular type of home equity conversion designed for the elderly. Reverse mortgages can enable parents to convert some of their home equity into cash while *retaining ownership* of the house. These mortgages turn the cash flow of the regular mortgage around. Instead of getting a lump sum and paying it back in monthly installments, the loan is advanced to the homeowner as fixed monthly payments. Nothing is paid back until the term is up when the advance, plus interest, must be repaid, presumably with the proceeds from the sale of the house.

With this method, an institution lends the parents up to 80% of the value of their home, for example, over a ten-year period in monthly installments that yield a steady flow of tax-free income. At the end of ten years, the $100,000 house has an $80,000 mortgage against it, but the property may have increased in value. At this point, the parents can sell the house and pay off the mortgage plus accrued interest or refinance by applying for another reverse mortgage. However, if property values decrease, paying off the loan or refinancing could be difficult.

Fixed term reverse mortgages work best for elderly people who need income for a specific length of time. For example, until a pension plan or annuity begins payment or space in a retirement housing development opens up.

A new plan, called the **shared appreciation reverse mortgage**, may be more suitable for people who want to live in their homes for the rest of their lives. To qualify, the homeowner must be age 62 or older and the house must be in good condition. Under a shared appreciation plan, the homeowner gives up all, or a portion of, the property's future appreciation. The bigger the amount of future appreciation the borrower is willing to give up, the bigger the current monthly payments. Upon death, the loan, accrued interest, and the bank's share of the appreciation is repaid from the estate after the house is sold. The remainder, if any, goes to the heirs.

Feasibility of These Arrangements

A sale-leaseback can be utilized anywhere in the nation, but reverse mortgages, a relatively new development in financing, are currently available only from a few savings and loans, banks, and mortgage bankers in about a dozen states. In some states, fixed term type reverse mortgages are allowed while shared appreciation mortgages have yet to be approved. The concept may spread faster now that a federally-funded insurance program allows borrowers to remain in their homes if they outlive a reverse mortgage term.

Three-quarters of Americans 65 or older own their own homes and 83% of them have paid off mortgages. Home equity conversions can put these assets to work generating income that allows the elderly to live off their homes, as well as in them.

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