

Accessing Property Capital

FUNDING OPTIONS FOR THE OVER 60s – ISSUES FOR ESTATES/REMARRIAGES

Scenario 1

- 1.1 Mr and Mrs Brown have been married for 50 years, and have three adult children. They are living in their own home which has a value of \$550,000. They have just discovered they have to repair the roof which will cost \$30,000. They have no cash reserves to fund this repair. How do they fund the repair?
- A. Approach the children for a loan. This can be formally recorded in a deed, with the loan to be repaid on the death of both of them or the sale of the property. Provides certainty for Mr and Mrs Brown but the children's investment does not "grow" and, typically, does not pay interest.
 - B. The children purchase a share in the house. This provides cash for the couple, plus also enables the purchasing children to share in any potential capital growth, or loss.
 - C. Sell the property and either buy a smaller property or rent.
 - D. Take out a term loan from a bank with the interest "capitalised". This means borrowing the \$30,000 plus an additional amount to pay all interest for a calculated period of time. The couple draws down \$30,000 for the roof repairs and the remainder is retained to cover the interest. For a loan period of 10 years the total amount to be borrowed would be \$50,000 and the monthly interest amounts to \$160 at current rates.
 - E. Take out what is called a reverse equity mortgage. This enables someone over 60 to utilise the equity in their home to draw down funds. No repayments are required. The interest compounds. The loan is repayable upon the death of the survivor of the couple. This provides real certainty for the couple but can leave little or nothing of the value of the house for the children. The loan is capped at the value of the property. There are high entry fees for some of these loans, plus solicitor's fees, valuations etc. In addition the interest rate is higher than the standard bank housing loan rate.
- If Mr and Mrs Brown borrowed \$30,000 from Sentinel, in 10 years time the loan will be \$63,951. In 20 years that \$30,000 loan will have grown to \$131,101. There is no guarantee that property values will increase to ensure equity is retained in the house.
- 1.2 For each of the later options the children, on the death of both of their parents, may receive a lesser inheritance.

Scenario 2

- 2.1 We now change the scenario to what is becoming a very common situation. Mrs Brown has died after 50 years of marriage, under her will she has left everything to Mr Brown. Mr Brown has married June. June, a widow, has three children from her previous marriage.

2.2 June and Mr Brown are living in Mr Brown's house. June and Mr Brown have entered into a contracting out agreement, providing that the house is Mr Brown's. What are the consequences of each of the options now? What will Mr Brown's children inherit on June's death?

A. A loan from the children. The children of Mr Brown.

Mr Brown dies, under his will June has a life interest in the house. The loan, realistically, will not be repaid until June's death. Mr Brown's children may not be happy with this, but ultimately they will get the value of the house.

B. The children purchase a share in the house. Again, although the inheritance may be delayed, Mr Brown's children will ultimately get the share of the house owned by Mr Brown's estate.

C. Sale/rent. Again, the children's inheritance will essentially remain intact, being either the smaller house or the remaining cash proceeds.

D. The term loan may continue beyond Mr Brown's death. But there is a fixed term. The loan must be repaid at the end of 10 years unless renegotiated. The house may need to be sold and either a smaller house purchased or the sale proceeds invested and the income made available to June through her lifetime. The children's inheritance may be smaller but the "loss" will have been fixed prior to their father's death.

E. Under a reverse equity mortgage however the estate can be rapidly depleted. June and Mr Brown may both be the borrowers. The loan will continue on after Mr Brown's death. If the balance of the loan at Mr Brown's death was, say, \$63,951 and if June lives for another 10 years the loan balance will, using Sentinel's current prevailing interest rate of 7.2%, increase to \$131,101. Mr Brown's children will not be happy with this result.

Many over 60s are asset rich but cash poor. For many their home is their only asset available to fund their lifestyle. The options set out above are regularly being considered by families. All families are different, and the ideal options involving funding from within the family may not be available to many families. We recommend that if the only options are to borrow from outside sources, careful consideration should be given to the family dynamics now and going into the future, and to existing estate planning.

For more information, please contact:

Howard Johnston

Partner

t: 09 979 2161

e: johnston@brookfields.co.nz

Alison Gilbert

Senior Associate

t: 09 979 2253

e: gilbert@brookfields.co.nz

The contents of this publication are general in nature and are not intended to serve as a substitute for legal advice on a specific matter. In the absence of such advice no responsibility is accepted by Brookfields for reliance on any of the information provided in this publication. © Brookfields

Auckland **Manukau** **Wellington**
t 09 379 9350 09 262 2145 04 499 9824
f 09 379 3224 09 379 3224 04 499 9822
www.brookfields.co.nz



Brookfields
LAWYERS