

## OUR HOME - CHARITABLE REVERSE MORTGAGE

Suppose that you and your wife are both 70 years young and that the value of your home is \$1,000,000.

For someone who is philanthropic this is a tremendous amount of net worth tied up in one asset. We really don't want to sell the house and we don't want to take out a traditional mortgage as it requires that we make mortgage payments since we are typically debt free and most likely reluctant to take on further financial obligations.

There is a financial product available called a reverse mortgage that uses the equity in your home as collateral to pay out a lump sum of cash to the homeowner. The lump sum of cash paid out is based on your age and house equity value. There are no monthly payments as interest is capitalized each year and added onto the existing mortgage. The reverse mortgage is paid out from the proceeds you receive when you sell the house, or if you pass away the reverse mortgage is paid by your estate out of these same proceeds. In summary, you have received a lump sum of cash now which can be used to further your philanthropy and family legacy desires. You will continue to own and live in your house for as long as you wish and you will not incur any further monthly expense obligations.

### **SCENARIO I - Make no changes**

Your \$1,000,000 house grows at 5% per year over the next 15 years, it will be worth \$2,078,928 at age 85. If you pass away at age 85 your heirs will receive \$2,078,928 tax free.

### **SENARIO II - Charitable Reverse Mortgage**

**STEP 1** - At age 70, a house valued at \$1,000,000 could be used as collateral for a reverse mortgage of \$313,764.

**STEP 2** - You will now have \$313,764 to use to further your philanthropy. Let's assume you donate these funds to the capital campaign of your favourite charity. The future value at age 85 of the \$313,764 contribution made in 2006 will be \$488,834.

Another possibility for you is the creation of a Family Foundation. The \$313,764 would be donated to your personal donor-advised fund, a fund which is typically managed on your behalf by a community foundation like The Calgary Foundation. Your family's sole responsibility in this case is to advise The Calgary Foundation as to which charities you would like to receive the annual 5% disbursement. Your disbursement in year one would be \$313,764 @ 5% = \$15,688.

Your donor-advised fund will be an endowment that is meant to be a lasting legacy of you and your family. Your donation of \$313,764 is invested by The Calgary Foundation and managed by their professional money managers. I have illustrated that a Family Foundation grows at 1% over disbursement and expenses; this means a long-term rate of return of 7.25%. Based on this calculation your Family Foundation at age 85 would have disbursed to charity the equivalent of \$338,414 over 15 years and the fund would have grown to a value of \$367,913. Your family's impact on the community at that point would be \$706,327 with your family disbursing \$20,000 annually from the fund you had set up 15 years earlier.

**STEP 3** - In recognition of our benevolence the Federal and Provincial Governments have legislated tax incentives to motivate tax payers. Currently a donation of \$313,764 would generate a tax credit of \$130,996. Proper planning would be required to ensure the full tax credits will be realized. Assuming we eliminate taxes of \$130,996 we would have that money available to invest.

**STEP 4 (a)** - If you have the option of obtaining life insurance, a one time payment of \$130,996 would purchase a \$450,000 life insurance policy. There would be no further premiums required and the policy would pay the death benefit to the estate on the last to die. On your death the remaining equity of the house and the \$450,000 life insurance policy would be paid to your heirs.

**STEP 4 (b)** - If you are un-insurable then an investment of \$130,996 growing at 5% after tax has grown to \$285,948 at age 85. On your death the remaining equity of your house and the investment growth would be paid to your heirs.

**SUMMARY** - At age 70, a house valued at \$1,000,000 would qualify for a lump sum payment of \$313,764. As suggested if you passed away at age 85, after the capitalization of all the interest payments the mortgage owing at that time would have accumulated to \$692,634. Therefore after paying off the mortgage the net equity to your heirs is \$1,386,294.

The following table is a comparative of the impact on your estate and social legacy of taking a reverse mortgage to make a charitable donation.

At Age 85	House	Capital Campaign		Family Foundation	
House Legacy	\$2,078,928	\$1,386,294		\$1,386,294	
Tax Credit Re-invested		Invest \$285,498	Life Insurance \$450,000	Invest \$285,498	Life Insurance \$450,000
Total to Heirs	\$2,078,928	\$1,671,792	\$1,836,294	\$1,671,792	\$1,836,294
Social Legacy	\$0	\$488,834		\$706,327	
<b>Total Legacy</b>	<b>\$2,078,928</b>	<b>\$2,160,626</b>	<b>\$2,325,128</b>	<b>\$2,378,119</b>	<b>\$2,542,621</b>

An illustration and a detailed spreadsheet of all the analysis discussed is attached.