LESSON · HOUSING

Downsizing in Retirement: What It Really Frees Up

Downsizing can free up cash and lower your monthly costs, but less than the sale price suggests. Here's how to count what you actually keep, before you put up the sign.

Read time: 6 minutes **Level:** Foundational **Includes:** Knowledge check

For many retirees, the house is the biggest asset they own. Selling it and moving somewhere smaller can do two things at once: put cash in the bank and lower the cost of living every month. Both can be real. Both are also easy to overestimate.

The useful question isn't "What will the house sell for?" It's "After every cost, how much money do we keep, and how much lower are our monthly bills?"

What you keep isn't the sale price

Between the sale price and the cash in your account sit several costs that are easy to forget:

- **Selling costs.** Agent commissions, closing costs, transfer taxes, and repairs or staging to get the home ready.
- **Buying costs.** Closing costs on the new home, inspections, and any updates it needs.
- **Moving costs.** Movers, storage, and new furniture that fits the smaller space.

The home-sale tax exclusion

The IRS lets you exclude up to **$250,000** of gain on the sale of your main home, or up to **$500,000** on a joint return. To qualify, you generally must have owned the home and lived in it as your main home for at least 2 of the 5 years before the sale, and not used the

exclusion on another home in the past 2 years. Gain above the exclusion is reported as a capital gain.

Your gain is the sale price, minus selling costs, minus your basis: what you paid plus the cost of major improvements. Keep receipts for those improvements; they lower your taxable gain.

A worked example

A married couple bought their home for $250,000 and spent $50,000 on major improvements over the years. They sell it for $600,000 and buy a $400,000 condo.

What downsizing frees up

ITEM	AMOUNT
Sale price	$600,000
Selling costs (about 7%)	−$42,000
New condo	−$400,000
Buying and moving costs	−$15,000
Cash freed up	**$143,000**

Their gain is $600,000 − $42,000 − $300,000 basis = $258,000. That's under the $500,000 joint exclusion, so no federal tax is due on it. A single seller with the same gain would owe capital gains tax on $8,000. Illustrative figures.

The monthly savings matter as much as the cash

A smaller home usually costs less to run every month, for the rest of retirement. That can matter more than the one-time cash.

Monthly costs, before and after

COST	HOUSE	CONDO
Property tax	$1,000	$650
Insurance	$250	$120
Utilities	$400	$250
Maintenance and repairs	$500	$150
HOA fee	$0	$450
Total	**$2,150**	**$1,620**

They save $530 a month, about $6,360 a year, which lowers the paycheck they need from savings. Note the HOA fee: it can rise, and some communities add special assessments. Illustrative figures.

Smaller doesn’t always mean cheaper

A new condo in a more expensive area, high HOA fees, or a move to a state with higher taxes can erase the savings. If you’re moving to another state, compare its taxes first. The State Taxes lesson shows why where you live can change your tax bill.

Before you decide

1. **Price the whole move,** not just the sale: selling, buying and moving costs.
2. **Estimate your gain** using your basis and improvements, and check it against the exclusion.
3. **Compare monthly costs** line by line, including HOA fees and insurance.
4. **Decide what the freed-up cash is for:** a safety cushion, future care, travel or your heirs.
5. **Think about timing.** Downsizing while you’re healthy and on your own schedule is easier than doing it in a hurry later.

How Blueprint approaches this

- Your **Housing** line covers your mortgage or rent, property taxes, utilities, HOA fees and repairs. If you plan to downsize, choose to adjust your retirement budget and enter the new, lower costs in today's dollars.
- With Plus, enter the sale as a **Cash Windfall** in the year you expect it, with the taxable gain (if any) and its tax treatment. Windfalls flow into your three Engines: Liquidity first, then Income, then Growth.
- Enter the new home as a **Future Large Purchase** (Plus). Large purchases are paid from your Growth Engine, and Blueprint flags a **Funding Gap** if Growth can't cover it.
- A **what-if scenario** (Plus) compares "sell and downsize" with staying put, side by side, without changing your saved plan.

Before you downsize:

- [ ] Gather your purchase price and improvement receipts
- [ ] Estimate selling, buying and moving costs
- [ ] Check your gain against the $250,000 / $500,000 exclusion
- [ ] Compare monthly costs, including HOA fees
- [ ] Compare state taxes if you're moving
- [ ] Decide what the freed-up cash is for

KNOWLEDGE CHECK

Test what you just learned

Answer four quick questions to test what you just learned.

1. How much home-sale gain can a married couple filing jointly generally exclude?

- A. $100,000
- B. Up to $500,000
- C. All of it, always

2. What lowers your taxable gain on a home sale?

- A. Selling costs and the cost of major improvements
- B. Your monthly utility bills
- C. Your mortgage interest

3. In the example, how much cash did downsizing free up?

- A. $600,000
- B. $200,000
- C. $143,000

4. Why can a condo cost more than expected?

- A. HOA fees can rise and special assessments can be added
- B. Condos never have property tax
- C. Utilities are always higher

Part of **Housing** in retirement: **See the full Housing guide →**

Sources: IRS, Topic No. 701, Sale of Your Home; IRS Publication 523, Selling Your Home.

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