



of San Diego

HOME

PLANNER RESOURCES

MORE CASH-STRAPPED RETIRED HOMEOWNERS SHIFTING INTO REVERSE MORTGAGES

Cash-strapped older homeowners looking to tap their bulging home equity as a way to supplement retirement income are taking a new look at the once obscure—and sometimes reviled—reverse mortgage. But before shifting into reverse, understand the product well and consider the alternatives, caution financial planners.

A reverse mortgage is as the name says: instead of you making payments to the mortgage lender, the lender makes payments to you. Most important to house-rich, cash-flow-poor seniors, you don't have to repay the loan until you and your spouse die, sell the home, or move out of it permanently.

Payout options are a lump sum, monthly payments, a line of credit you can use whenever it's needed, or a combination of options. How much you can borrow depends mostly on how much available equity you have, your age, current interest rates, the lender and sometimes where you live. In general, the older you are and the more equity you have, the larger the amount you can borrow, though federally backed programs have caps.

For example, according to an AARP online calculator, a couple age 75 with a paid-off home with \$250,000 in equity, using a federally insured FHA reverse mortgage, could receive a lump sum or line of credit of \$160,467, or monthly annuity payments of \$1,080 for as long as both or one of them live in the home. In contrast, a 65-year-old couple would receive only \$135,891 in a lump sum.

Another feature of reverse mortgages is that you can never owe more than the value of your home at the time the loan is repaid—even if the home has lost value in the interim or you outlive your life expectancy and the total annuity payments, fees and interest charges exceed the value of the home. The lender cannot claim other assets you may have in order to pay off the loan. If there's equity left over after the loan is repaid, you or your heirs keep the remaining proceeds.

To qualify for a reverse mortgage, you must be at least age 62 and own a home or condominium with accumulated equity. Any outstanding loans against the house are usually paid off by the reverse mortgage. Unlike other home equity loans, there are no income or credit requirements.

While reverse mortgages have been around for years, they've never been very popular, especially compared with other forms of home equity loans. But with rising home equity values, shrinking retirement income, low interest rates and a mushrooming senior population, interest in reverse mortgages is climbing.

So what's not to like about reverse mortgages, especially when you don't have to make monthly payments? The biggest concerns are steep costs and, in some cases, lender abuse. Alternative sources of funds often are a better deal.

Let's start with fees and interest payments. The cost of origination fees, mortgage insurance premiums, appraisal fees and numerous other closing costs can run well into the thousands. Yet consumers often don't notice these costs because they're rolled into the loan—you don't have to pay them out of pocket.

Private lenders are even more expensive than federally backed loans, though they allow much larger loans than federally backed lenders. And at least one private lender was involved in a recent class-action lawsuit, reminiscent of abuses in the early days of reverse mortgages. Of particular concern, warn some experts, is when private lenders share in the appreciation of the value of the home.

The frequently high upfront fees are one reason why financial planners typically recommend that seniors don't consider a reverse mortgage unless they anticipate needing a substantial amount of money and they plan to live in the home for a long time. Seniors should carefully compare a reverse mortgage with alternatives that may be less expensive. These include home equity loans, home equity lines of credit, easy qualification refinancing, or selling the home, moving to a less expensive place, and using the net profits to supplement income. Children also might be in a position to co-sign a refinancing or lend money, which might be repaid out of the eventual estate.

Federal law requires financial counseling from approved agencies before taking out a reverse mortgage. Consumers would be wise to take the counseling sessions seriously.

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