Considering a reverse mortgage?

by Alex Chastain, CFP®

A reverse mortgage is a non-recourse loan offered to homeowners which allows the owner to access money from the home's equity. For many years reverse mortgages have been considered to be "loans of last resort" due to the high up-front costs, but with the standardization of loan terms, low interest rates, and the introduction of lower fees from the FHA "saver" option in 2010, both consumers and financial advisors are reconsidering the reverse mortgage. Reverse mortgages can provide retirees with tax-free monthly income, access to credit as needed, relief from mortgage payments, increase in portfolio longevity, and support of the desire to "age in place." These benefits do come with a price, so, as with all financial decisions, it is important to understand the implications of a reverse mortgage to determine whether this type of loan is right for you.

How will you receive the money?

Should you decide to seek a reverse mortgage, you can receive payments from the lender in the form of a lump sum, monthly payments, or a line of credit. While a reverse mortgage has no ongoing payment requirements, the unpaid interest on the home accrues on the outstanding balance. The loan must be repaid if the borrower sells the home, moves out of the home, dies, or fails to take care of the property. If you choose to take a lump sum, know that after the money is gone the balance on the loan continues to grow, thereby decreasing the equity in the home. A lump sum option rather than a fixed income option could leave you years later without financial resources to stay in your home or to facilitate a move.

What do you need to know as a potential borrower?

As a borrower, be sure you have the necessary funds to pay these expenses now and in the future. You can face foreclosure if you fail to properly maintain the home or pay property taxes and homeowners' insurance. Non-borrowing members may be displaced from the home if the borrower dies or moves. This may include a spouse who is not a co-borrower. If you are married, put both names on the loan to avoid having your spouse displaced. Be sure to think through whether a dependent or a child would be displaced in the event of your death or a move. If you are considering a reverse mortgage to "age in place," the amount secured may be a fraction of the amount needed. You will typically need to have other income or financial resources to cover the expense of in-home care.

When can you apply for a reverse mortgage?

While reverse mortgages are offered to homeowners who are over age 62, it is usually best for borrowers to obtain a reverse mortgage in their 70s or later. Borrowing young can have significant impact on resources available later in life and lock you into an unwanted situation. You may be able to have more equity by waiting and borrowing at a later age, obtaining a traditional home equity loan, or by selling your home. The amount available to borrow is limited and the proceeds you actually receive can be considerably less than the loan amount due to the fees. Plan to remain in your home for a long time due to the costs of the mortgage loan.

While the reverse mortgage can be an effective tool for some, it is important for retirees to proceed with caution and understand how it works, look at all available options and then determine whether it's appropriate for your specific situation. Check with your financial planner to decide if a reverse mortgage is right for you. For more information, see the following websites:

http://www.aarp.org/money/credit-loans-debt/reverse_mortgages/

http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea13.shtm

http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-report-finds-confusion-in-reverse-mortgage-market/

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