IS A REVERSE MORTGAGE RIGHT FOR YOU?

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A reverse mortgage (also known as a Home Equity Conversion Mortgage (HECM)) is a type of loan, and also a retirement planning tool, that may be utilized by seniors to tap into the equity of their homes for the purpose of supplementing their fixed income. In the Nutcracker, I mean in a nutshell, a homeowner, age of 62 or older, may utilize a reverse mortgage to borrow against their home's equity. Under the terms of this type of mortgage, the owner continues to hold title to their home.

A reverse mortgage can be a valuable retirement resource as many seniors' largest asset is their home. Imagine if you could open up a line of credit, like a checking account, and be able to utilize the value of your home to help pay for your cost of living, all while still residing in your home. It would be like a great Christmas gift (not really that good, keep reading).

We all know how a conventional mortgage works. Money is borrowed from a lender in order to purchase a home. Then most of us make payments for fifteen to thirty years. With each payment made, the borrower's amount of ownership increases, and then one day the home is paid off (both joyful and triumphant). I have a vague childhood memory of my parents burning their discharge of mortgage as a way of celebrating this major life event (like visions of sugar-plumbs dancing in my head).

So, how does a reverse mortgage work? It is kind of the reverse of the conventional mortgage. Instead of making payments and increasing your principal, you receive payments (can be lump sum, monthly installments or set up as a line of credit so you can take it when you need it (that will get you into the spirit) and as you receive the disbursements the equity in your home decreases. You don't make a payment on the funds you receive, you just receive funds from the lender. During the course of a reverse mortgage, you may sell the home at any time, subject to the reverse mortgage. Of course, the loan balance grows over time as money is withdrawn and interest accrues (like finding coal in your stocking). As you can see this is the reverse of the traditional mortgage, hence the name "Reverse Mortgage."

Since I don't make payments, what am I responsible for? You will need to continue to keep your home in good repair, maintain homeowner's insurance and pay your property taxes (make a list and check it twice). You also need to keep your home as your primary residence.

When does a reverse mortgage need to be paid back? The reverse mortgage lender is repaid when the you die, no longer utilize the home as your residence, or your home is sold. Upon your death, the debt to the lender will need to be repaid and the remainder would become part of your estate. What if you become ill and need to leave the home and cannot return, such as in the case of needing nursing home care? Same result more or less, you would sell your home, repay the debt and keep the remaining sale proceeds.

What does this mean for you?

Unfortunately, many seniors who are living on a fixed income don't have the enough income/assets to fully enjoy retirement, and may even fall short of being able to pay for necessities, like food and medication. If utilized wisely (think wise men or women), a reverse mortgage can be a powerful tool for those who need additional funds on a monthly basis to keep up with their cost of living or whom incur an expense they could not otherwise afford (like a new roof, furnace, automobile or a sleigh and eight reindeer). Tapping into their biggest resource may alleviate the shortfall and improve quality of life significantly, perhaps allowing the senior to stay in their home, which may be their preference.

How do I qualify for a reverse mortgage? First off, as stated previously, you need to be at least 62 years old. Second, you will need to have equity in your home. Also, you have to prove that you have enough income to afford to pay your taxes, insurance, and basic home maintenance. Beyond that, a formula is done regarding the amount of equity you own in your home, interest rates, your age, etcetera. Note: if you have a conventional mortgage in place, the reverse mortgage may be utilized to pay off your traditional mortgage if the conventional mortgage does not represent too large a percentage of the value of your home.

Hold on, it is not all fun and reindeer games.

Reverse mortgage lenders are taking on significant risk. How is that you ask? When they make a loan to you based on your life expectancy, then every year you live is another year they don't get paid. For example, what if you borrowed at age 62 in an up market, then live to be 105 years of age and at the time of your passing the markets are down? The lender may likely lose, financially speaking, as their lien is only on the property itself.

Well, the reality of this risk is not lost on lenders, and therefore the cost of setting up a reverse mortgage can be rather expensive as compared to a conventional mortgage. It is true that all mortgages have costs, which can include the interest rate, loan origination fee, mortgage insurance fee, appraisal fee, title insurance fees, and various other closing costs, but reverse mortgage fees are high when compared with the traditional mortgage. I'm sure costs are all over the map, but the last two reverse mortgages I aided clients in acquiring cost those clients between $10,000 and $12, 000. If the fees scare you, they should. If you still feel compelled to utilize this tool, then you will want to know that the fees can be added into the loan.

In my practice, I see a reverse mortgage as a tool for my clients. That being said, I typically see this as a tool of last resort. It may be best to sell your home and invest the proceeds so you earn interest rather than paying interest, but this is a decision that would be based on all the facts at the time and your personal preferences. Merry Christmas (Happy Hanukkah) to all and to all a good-night.

The information provided in this article does not constitute legal advice, not even to Mr. & Mrs. Santa Claus.