

Caregiver's Home Companion

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Reverse Mortgages: Buying Time and Continuing to Live Independently

By Ursula Furi-Perry

With utility bills rising, energy costs soaring, and the future of social security arguably becoming less and less certain, your loved one may be elated to hear about a fairly new option for generating income. If your loved one is over 62 and lives in her own home, she may qualify for a reverse mortgage, a tool which can allow her to convert the equity in her home into cash. In essence, a reverse mortgage offers seniors money from a lender each month without having to sell their homes, allowing cash-poor homeowners to pay off monthly bills.

On the positive, reverse mortgages appear to be a safe bet in the appropriate situation. "I think reverse mortgages are closely regulated," says George Middleton, CPA-CFS, a financial advisor at Limoges Investment Management PC in Vancouver, WA. "They do a good job of providing information to the prospective buyer," making it less likely that a loved one will be duped into a daunting deal. "They're a great means to maintaining autonomy and independence," says Bronwyn Belling, reverse mortgage specialist at the AARP Foundation.

Yet not everyone is the right candidate for one. "Reverse mortgages are most appropriate for those seniors who are house-rich, but cash-poor," explains Paul N. Winter, Principal of Five Seasons Financial Planning in Holladay, UT. "They should be used as a last line of defense against running out of money in retirement. For that reason, I don't think they should be used to fund non-essential items [such as] vacations, boats, recreation, or for short-term needs, since origination fees are quite steep." Belling describes the typical borrower as a widowed woman, about 75, living in a house worth about \$250,000. "Everyone's needs and circumstances are different," says Belling, "even if you have two identical houses in a neighborhood, the amounts can vary as to how much they can borrow."

"One aspect that might make reverse mortgages too good to be true in this current environment is that rates on them are variable," says Winter. "While they do come with caps, interest expense may increase over time." Though many experts say rates on reverse mortgages aren't outrageous, they may not be the most advantageous out there when compared with conventional loans. As such, experts advise caregivers and loved ones to research and discuss other possible options before signing up for a reverse mortgage. For example, "if someone needs home repair or some help with utility bills, there may be some local programs [that are more advantageous,]" Belling says.

Fees may be another concern, making reverse mortgages unnecessarily costly. “The fees are “hidden” in the sense that they are tacked on to the loan balance and interest is paid on them the entire time the loan is outstanding,” says Middleton. “The fees don't really come to light until it is time to repay the loan.” Belling points out that most fees are paid out of the equity and spread out; as a result, she recommends that borrowers plan to remain in the house for a long period of time to come.

“Also, the vast majority of reverse mortgages come with limits as to size, so homeowners may not be able to take full advantage of the recent appreciation of their homes,” Winter states. And reverse mortgages may even mean less freedom, experts say. “Normally the loan is due upon death of the homeowners, but what if the home owners want or need to move, say into a nursing home?” Middleton points out. “That could trigger a repayment clause.” Belling says some provisions are in place for such situations: if a lone borrower or both joint borrowers have to move into a nursing home, say, or receive medical treatment that prohibits them to live at home, the mortgage stays intact for up to a 12-month consecutive period. Additionally, if one borrower remains in the home, the mortgage stays in effect as well, with nothing due.

Upon all borrowers moving out of the home, selling the home, or passing away, the reverse mortgage becomes due to the bank. This may influence the loved one’s estate planning, as the heirs will be responsible for any bank payments upon death—that may mean selling the home and paying off the mortgage before distributing the remaining assets. It’s also important to dispel the popular myth that the bank “owns” the house when a reverse mortgage is placed on it. “The owner is still the owner of the home, and responsible for taxes and insurance,” says Belling. “It becomes much more important to protect the house and make sure it’s maintained and occupied because it’s the sole collateral for the loan...and has to be the primary residence according to the IRS’s definition.”

As for picking the right financial institution, “the program is fairly uniform, so the actual provider is not that big of an issue in my view,” says Middleton. Because rates are regulated in the industry, one major factor when deciding on the right financial institution may be closing costs, Winter says. Research lenders thoroughly and ask around for references. Also, get all quotes and other information in writing so that you can better compare rates and choose the most favorable one for your loved one. “Candidates may also be required to visit a counselor as a prerequisite anyway, and this counseling may be useful as an educational process,” adds Winter.

All in all, reverse mortgages may be a great tool when the situation is right, but they should come about after plenty of research and thinking. “I view a reverse mortgage as a last resort,” says Middleton. “It should only be considered if there is a gap between monthly expenses and monthly income that cannot be resolved some other way.” Adds Belling, “reverse mortgages can be really helpful when the caregiver has exhausted other resources. Sometimes, they’re not a permanent solution, but may allow someone to buy more time and care for their loved one as they would like to.”

Resources:

The National Center for Home Equity Conversion, independent consumer website on reverse mortgages, <http://www.reverse.org/>

U.S. Department of Housing and Urban Development, reverse mortgage pages, <http://www.hud.gov/buying/rvrsmort.cfm>

National Reverse Mortgage Lenders Association website, <http://www.reversemortgage.org/>

American Association of Retired Persons, reverse mortgage information, <http://www.aarp.org/money/revmort/>

Federal Trade Commission's information about reverse mortgages, <http://www.ftc.gov/bcp/conline/pubs/homes/rms.htm>

<http://www.caregivershome.com/news/article.cfm?UID=844>