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IS A REVERSE MORTGAGE RIGHT FOR YOU?

BRENTWOOD, Tenn. – Reverse mortgages have become a popular option for seniors who would like to reap some of the benefits of the equity they have built up in their homes. However, it's important to be aware of both the advantages and drawbacks to these loans. The Tennessee Society of CPAs explains how they work and the issues to consider.

THE BASICS

A reverse mortgage is simply a different kind of home loan, one that is generally only available to people 62 and over. Instead of borrowing to buy a house, the homeowner gets a loan based on his or her equity in a home he or she already owns. Say, for example, that you own a home worth $200,000 with no outstanding mortgage on it. You are nearing retirement and would like to add some extra income to your retirement savings. The bank offers you a reverse mortgage of $75,000. You can choose to receive the money in payments spread out over time - for example, monthly- or in a lump sum payment. You can also set up the loan as a line of credit that you can tap into as needed. You do not have to make any repayments until the home is sold or until you die or move, even if you outlive the loan term. And you do not have to move out of the home when the loan term ends, either. When the home is sold or you move out of it, you or your heirs must repay the $75,000 - with interest and fees - out of the sale proceeds.

QUALIFYING FOR A REVERSE MORTGAGE

In addition to being 62 or older, to qualify for a reverse mortgage you must own the home outright and live in it as your principal residence. If you have an existing mortgage on the home, it should be a relatively small one that you will pay off with some of the reverse mortgage proceeds. Your income is not a factor in the loan decision, since you will be receiving payments, not making them.

CONSIDER THE DISADVANTAGES

A reverse mortgage can be a great way to free up equity in your home to use during retirement. However, it is not always advisable. It's probably a better deal if you are in your 70s or older rather than in your 60s, in part because the bank will likely be willing to give you a bigger loan because decisions are made based on your life expectancy. In addition, if you expect to downsize, move closer to family or transition to an assisted-living or similar facility sometime in the future, remember that you will have to pay the loan amount back to the bank when you sell your home. That means you will have less money to spend on your next residence.

DIMINISHED INHERITANCE

One of the biggest drawbacks of a reverse mortgage is its impact on the inheritance you leave. In our example above, after the $75,000 loan amount - plus interest and fees - is deducted from the value of a $200,000 home, there will be less money left for your heirs, a key issue to consider before taking this type of loan.

READ THE FINE PRINT

It's also important to ask questions about the responsibilities facing you down the road. Find out about the interest rate and fees on the loan, and how much they will amount to when the mortgage is paid off. Especially with home values dropping during the last year, you don't want to learn that the total amount you owe later is more than the value of your home.

About Money Management

Money Management is a weekly column on personal finance prepared and distributed by the Tennessee Society of Certified Public Accountants (TSCPA) as a part of its financial literacy initiative.

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