Reverse Mortgage; The Good, The Bad, and The Ugly

Many Americans facing retirement have a need to increase their monthly income. Fortunately, there is a way that homeowners can use their homes to help finance their retirement — to turn the value of their property into usable cash without the emotional trauma of having to sell and move.

If you are older and have substantial equity in your home, a reverse mortgage may be able to give you a valuable supplemental source of retirement income. You can receive this income based on the equity that you have built up over the years in your home--without having to repay the reverse mortgage during your lifetime.

The amount of the monthly payment you receive from a reverse mortgage depends on four factors:

1. Your age
2. The amount of equity in your home
3. The interest rate charged by the lender
4. Closing costs

The Good:

- To be eligible, all owners on the deed must be age 62 or older and the home must be the principal residence of at least one of the owners.
- With a reverse mortgage, you can effectively annuitize your home. The monthly payment you receive is computed using standard annuity methods that take into account your age and life expectancy (as well as your spouse's life expectancy if you are joint borrowers), the appraised value of the property, current interest rates, the type of distribution you choose, and the amount of equity that you assign to the loan company.
- The income you receive is generally tax-free and doesn't affect your Social Security and Medicare benefits.
- Even though this is a home loan, you don't have to repay the principal, interest, and fees for as long as you (and usually your surviving spouse) continue living in the home or until the property is sold.
- The Home Equity Conversion Mortgage (HECM) is a federally insured reverse mortgage that is generally less expensive than private-sector reverse mortgages, though you typically are charged mortgage insurance premiums.

The Bad:

With a reverse mortgage, you must mortgage your home to the lender. Each payment that you receive from the lender increases the amount of principal and interest that you owe on the mortgage. Although the mortgage typically does not become due while you're still living in the home, the equity value of your home is reduced by each payment that you receive. This reduction in the equity value of your home may have a negative effect on your heir's ultimate inheritance.

A reverse mortgage may have other drawbacks, including:

- High up-front costs
- No reduction in homeowner costs (Insurance, Property Taxes, home maintenance, etc.)
- Interest Compounding Against you
- Nothing Left for Heirs
- Could Affect Public Assistance
- Limits to what you can borrow (about $625,000 on an HECM reverse mortgage)
- Can become Payable on Demand in the following circumstances:
    1. Not maintaining and/or repairing the home
    2. Failing to pay property taxes
    3. Failing to insure the property
    4. Adding a new owner to the property's title
    5. Incurring new debt that uses the home as collateral for the loan

The Ugly!:

If any of the following apply to you, a Reverse Mortgage may not be for you:

1. You want to leave home to heirs
2. You live with someone other than your spouse
3. You foresee a need to move into an assisted living facility
4. You will likely move in the near future
5. You can't afford property taxes, homeowners insurance and/or home maintenance

If a reverse mortgage meets your needs and lifestyle objectives, it could be one way to increase your monthly income during your retirement years. However, because of the costs and conditions involved in a reverse mortgage, you should weigh your options carefully and consult with a professional who can explain the full implications.