InvestTalk Insider

Special Info Sheet Series

Reverse Mortgages

What is a reverse mortgage and how it works is easily explained. What is much harder is deciding if you need or want one.

What is a Reverse Mortgage and what are the basic rules that apply?

A reverse mortgage, also called a Home Equity Conversion Mortgage, (HELM) is a special kind of home loan for older people. You have to be 62 or older and have a lot of equity in your home. That equity is used to borrow money that you never have to pay back as long as you live in your house. Once you pass or move out permanently you then have to pay back the reverse mortgage loan plus interest. You make no payments during the life of the loan and the loan never comes due until you either sell the house or move out.

Almost all banks charge an origination fee and other closing costs and maybe servicing fees over the life of the mortgage. These costs can add up and your debt balance will grow over time. Interest adds to the cost every month as if you are failing to pay the mortgage so they add back interest to the amount you owe. Most reverse mortgages have variable interest rates so if rates increase the amount owed not only goes up because you are not paying the mortgage, but the amount of debt can increase with rising rates. That can also go down with a falling rate. It is also a non-recourse loan. That means the lender can never come after any other asset you have to get paid back except the home the loan was made against. This is one reason they insist on a lot of equity left in the home even after they do the reverse mortgage.

The money from the reverse mortgage can be used for any purpose you wish.

Like any mortgage you have to qualify. Even though you are not making monthly payments and they are actually giving you the money from the reverse mortgage, they still want to make sure you are willing and able to pay the property taxes and the home owners insurance. They will check your credit and insist on some evidence of your ability to pay your taxes and insurance.

You can get the money in a single disbursement or fixed monthly cash advances over time or even over your life time. You can also use it as a line of credit where you draw down the loan proceeds at your convenience.

Reverse Mortgages are best for people who have significant equity, expect to stay in their home for the foreseeable future, and need immediate cash or cash flow stream. These are usually people over the age of 70. Those who plan to sell their home in the next few years or want to leave their home to children or grandchildren should probably not opt for a Reverse Mortgage.

Finally, be wary of sales pitches. Shop around and just like any normal mortgage you can get better deals from different lenders. Look for lenders who are members of the National Reverse Mortgage Lenders Association (NRMLA) and make sure you get a list of all fees and expenses up-front.

Most people use a reverse mortgage when they are property rich but cash poor. Some can't afford the repairs needed on a family home they have lived in for many years. A reverse mortgage is a good last resort but not the first resort you should consider. Still it is a very good solution if you want to stay in your home and can no longer afford it but have substantial equity in the home.

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