

Money for Life

March 2008

Dear Readers,

What is a reverse mortgage and is it right for you? A reverse mortgage is an arrangement in which a homeowner can borrow against the equity in his/her home and receives regular monthly tax-free payments from the lender. It is also commonly referred to as a home equity conversion mortgage.



These mortgages became popular as more people reached retirement age. Often the mortgages are used as a way for people to remain in their home and tap into their equity at the same time.

Reverse mortgages can be a convenient finance option for many seniors who would like to remain in their current home instead of selling it but be careful of lenders who advertise the loans as no-risk or no “downside”. These loans are expensive and often carry upfront fees of 5-6% on the home’s value... in **addition** to the interest you will pay on the loan. These costs are very similar to selling costs and it might be a better to sell the home now and move to a smaller more manageable living arrangement.

Advantages of a Reverse Mortgage

- The main advantage of reverse mortgages is that they are an extremely flexible financial planning product with few restrictions on how you receive and use the money and unlike a home equity loan, with a reverse home mortgage your home can not be taken from you. If you default on a home equity loan, you could lose your home.
- With a reverse mortgage loan lenders have no claim on your income or other assets and you will never owe more than your home's value at the time

the loan is repaid, even if the reverse mortgage lenders have paid you more money than the value of the home.

- The money borrowed with a reverse mortgage is typically tax free, since it’s a loan when the homeowner receives the funds, as either additional fixed income or a lump sum.
- There are very few restrictions how you use the funds received from a reverse mortgage. With a home equity loan the funds are used to upgrade the property, such as a kitchen update, or an addition. With a reverse mortgage you can use the funds to travel, get a hearing aid, purchase long term care insurance, or pay for your children’s college education.



- Payment options for these loans are also very flexible. You can receive the loan money in the form of a lump sum, an annuity, a credit line or some combination of the above.
- Some reverse home mortgages are federally insured - these are known as HUD's HECM FHA insured Home Equity Conversion Mortgages (HECM) reverse mortgages. With these, even if the reverse mortgage lenders default, you'll still receive your payments.

Disadvantages of a Reverse Mortgage

- Be careful with these loans if you are currently or will be eligible to receive low-income assistance from the Federal or State government (like Medicaid). The income from a reverse mortgage may disqualify you from that assistance. (NOTE:

Social Security and Medicare are not impacted by a Reverse Mortgage.)



- If you are planning to move in the near future then a reverse mortgage may not be the best choice for you. A reverse home mortgage loan is due if your

home is no longer your primary residence and the up front closing costs are typically higher than other loans.

- Many people do not choose a reverse mortgage as a retirement option because they want to be sure their home goes to their heirs. A reverse mortgage will decrease your home equity - affecting your estate. However, you can still leave your home to your heirs and they will have the option of keeping the home and refinancing or paying off the mortgage or selling the home if the home is worth more than the amount owed on it.

The best way to evaluate a reverse mortgage is to compare it to selling your home and using the proceeds to buy or rent a new home.

- Do you know how much cash you could get by selling your home?
- Do you know how much it would cost you to buy (and maintain) or rent a new home?
- Have you considered buying a less costly home, renting an apartment, or moving into assisted living or other alternative housing?
- Have you estimated the savings on home repair if you selected alternative housing?

Questions to Ask Before Considering a Reverse Mortgage

1) **Do you really need a reverse mortgage?** How do plan to use the money from a reverse mortgage? If you want to take a dream vacation, a reverse mortgage is a very expensive way to pay for it.

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2) **Is a reverse mortgage your most affordable choice?** These loans are very expensive, and the amount you owe grows larger every month. The younger you are when you take out a reverse mortgage, the more the compound interest will grow, and the more you will owe.

3) **Can you afford to start using up your home equity now?** The more you use now, the less you will have later when you may need it more, for example, to pay for future emergencies, health care needs, or everyday living expenses. You may also need your equity to pay for future home repairs or a move to assisted living.

4) **Do you have less costly options?** Do you have other financial resources that you could use instead of taking out a loan? If you don't, and if you could easily make the monthly repayments on a home equity loan or home equity line-of-credit, these alternatives are much less costly than a reverse mortgage.

5) **Do you fully understand how these loans work?** Reverse mortgages are quite different from any other loans, and the risks to borrowers are unique. Before considering one, you need to do your homework carefully and thoroughly.

If you are considering a reverse mortgage be sure to contact the AARP Foundation's Reverse Mortgage Education Project (800-209-8085; aarp.org/revmort). When choosing a lender, stick with specialists affiliated with the National Reverse Mortgage Lenders Association (reversemortgage.org).

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