Karen Telleen-Lawton: Reverse Mortgages Have Merit But Aren't for Everyone

They can work well for elderly homeowners with considerable equity who lack better options

Most seniors prefer to stay home, sweet home. (Karen Telleen-Lawton / Noozhawk photo)

By Karen Telleen-Lawton, Noozhawk Columnist | Published on 08.20.2012 3:40 p.m.

I'm not saying all reverse mortgages are bad. The idea has merit — allowing cash-strapped seniors to stay at home by borrowing against their homes' appreciated values. The loan doesn't become due until the homeowner dies or moves*. That's the abbreviated description, without important asterisks.

The advantages are enticing: You never lose your home as long as you abide by the agreement, you never owe more than the value of your house, you never have to repay during loan's life and the money isn't considered income (so it's not taxable). You can use the cash to repair or remodel your home, pay off debts or even travel.

The arrangement can work well for an elderly homeowner without better options, who has considerable equity in a well-maintained home. What happens when it's one-off from this description? Let's examine each element.

» **Elderly.** According to a MetLife study, the percentage of loans granted to young seniors (ages 62 to 64) has increased 15 percent since 1999. Moreover, 70 percent took a lump sum rather than an annual payment. This situation most likely puts homeowners in a worse position when they're truly elderly.

» **Homeowner.** If the mortgage is taken in only one name, the death of that mortgagee calls the loan and can force survivors to move. This is against the spirit of the loans and arguably against the regulations set up to protect seniors.AARP and Craig Briskin, a partner and head of the mortgage fraud group at a Washington, D.C.-based law firm, are researching a class-action suit againstHUD for failing to meet its regulatory responsibilities.

» **Without better options.** Reverse mortgages are like home equity lines of credit with repayment deferred, except they're much more expensive and complicated. There is a loan origination fee, closing costs and interest charges that accrue against an ever-growing balance. The Consumer Financial Protection Bureauestimates that fees and interest on a $166,434 reverse mortgage could amount to $56,300 after a decade.

» **Considerable equity.** The less equity a homeowner has to draw upon, the higher the costs and fees as a percentage of the loan.

» **Well-maintained home.** As a condition of the loan, the lender requires that homeowners keep current on property taxes, insurance and maintenance. If the homeowner can't maintain these payments, he or she could lose the house. Nearly 10 percent of reverse mortgage borrowers are at risk of foreclosure, according to the CFPB.

There are some safeguards designed to limit reverse mortgages to those for whom they're appropriate. Most lenders require prospective borrowers to meet with a HUD-approved reverse mortgage counselor before they will consider an application (find one at 800.540.2227).

There are alternatives. First, reduce your budget until your outflow is less than your income. If the Great Recession wrecked havoc on your nest egg, you need to recalculate how much you can draw each year to reduce the chances of depleting your savings. (A fee-only financial advisor can help with this.)

If reducing your budget is impossible (not merely uncomfortable), there are other possibilities that may be less costly. One is a plain vanilla home equity loan or even a traditional mortgage. Second is selling your house and moving somewhere less expensive, including senior housing. You may want to purchase an annuity with the difference, but these are also expensive.

Lastly, sell the house and move in with the kids. If you — or they! — don't like this solution, think about an even worse alternative: having to moving in with your kids after losing the entire equity in your home.

— Karen Telleen-Lawton's column is a mélange of observations spanning sustainability from the environment to finance, economics and justice issues. She is a fee-only financial advisor (www.DecisivePath.com) and a freelance writer (www.CanyonVoices.com).