

REVERSE MORTGAGE

What is a reverse mortgage?

Reverse mortgages are primarily directed at so-called "asset-rich, income-poor" retirees who have considerable wealth locked up in the value of their homes. Essentially it involves borrowing against the equity in one's home, with repayment of the principal and accumulated interest deferred until the property is eventually sold, either when the borrowers decide to move on, or when they die. Additionally, they have the option of repaying the reverse mortgage - thus taking back ownership - if they come into money. The equity may be realised as a lump sum or in the form of a regular payment.

With a conventional mortgage the borrower's equity in the property increases over time until the loan is fully paid out. With a reverse mortgage the opposite happens - the borrower's equity in the property diminishes over time. This occurs because the interest payable on the loan compounds. Thus \$50,000 borrowed by way of a reverse mortgage at an interest rate cost of, say, 7 per cent per annum would see the amount owed more than double in 10 years to just over \$100,000.

Given enough time, the amount owed could exceed the value of the property, because of the compounding effect on the borrowed amount. Reverse mortgages are highly sensitive to both changes in interest rates and movements in the value of the property that has been mortgaged.

Borrowers should also expect to pay up to 1 per cent above the standard variable mortgage rate for their reverse loans, together with the inevitable establishment fees. So reverse mortgages are hardly a bargain.

St George Bank revived its reverse mortgage product, this time under the banner of the "Seniors Access Home Loan". St George allows a maximum loan amount to \$80,000, or 15 per cent of the value of the property, whichever is the lower, for borrowers aged under 70. For borrowers who are 70 and over, the maximum increases to \$100,000, or 20 per cent of the value of the property. So the most that could be borrowed on a \$500,000 property is \$100,000, which is also the most you could get for a \$1 million home.

Commonwealth Bank launched a reverse mortgage offering it calls "Equity Unlock Loan for Seniors". The Commonwealth Bank's scheme allows borrowings of up to 35 per cent of your home's value to a \$225,000 maximum, which can be taken either as a lump sum or a regular payment. (St George's loan must be drawn down as a lump sum.)

Perhaps the best advice that can be given to intending borrowers is to thoroughly understand how the vehicles work.

What, for example, happens in the admittedly unlikely event that the loan outstandings start to exceed the value of your home? Could the property be sold out from under you, or does the lender wear the potential loss?

Consider having a solicitor scrutinise the loan agreement to establish precisely what your rights and obligations are under any reverse mortgage arrangement. It's also wise to consult a qualified financial planner to ascertain whether a reverse mortgage really makes sense in your financial circumstances, and to learn of alternative strategies that might achieve a similar outcome.

If you receive social security (e.g. the age pension), a good planner can advise on any impact the borrowings may have on your entitlements, and check the tax implications of a reverse mortgage.

Finally, it's prudent to discuss the matter with any children or other family members likely to be beneficiaries of your estate, because the value of any inheritance could be eroded by the existence of a reverse mortgage.

A useful way to evaluate a reverse mortgage is to compare it with the option of selling your home and using the proceeds to buy or rent a new (i.e. cheaper) home and living off the remaining proceeds. Ask yourself:

- How much cash can I get by selling the home?
- What would it cost to buy (and maintain) or rent a new home?
- How much income could I earn safely on any money left over after buying a new home?
- Are there any suitable alternatives? Could I sell my home to a family member and retain a life interest? Could I sell my home and build a granny flat on a family member's property, living on the proceeds made from the sale?