Baltimore style

The Truth About Reverse Mortgages

By Steven J. Sless, CLTC®

If you're retired or close to retirement, your home equity likely represents a large portion of your net worth. Understanding how to strategically and tax efficiently incorporate this wealth into your retirement plan may be the key to protecting and prolonging your nest egg.

A reverse mortgage offers one way to access this wealth. Many people think they know all about reverse mortgages, but with so much existing misinformation, deciphering the myths from the realities can be challenging. Learn how reverse mortgages work, some common misconceptions about them and ways they can be a viable tool for securing a better retirement.

How Do Reverse Mortgages Work?

Reverse mortgages provide qualified homeowners access to home equity, while retaining ownership of their home. These loans are designed to provide increased liquidity, accessibility and flexibility for qualified homeowners ages 60 and older.

The loans are called "reverse" because instead of making monthly payments to a lender—as with traditional mortgages—the lender pays the borrower. With a variety of payout options, reverse mortgages are among the most versatile type of mortgage loans available.

Borrowers are not required to pay back the loan until the home is sold or the last remaining homeowner permanently vacates the home. They can, however, make payments for any amount at their discretion without penalty.

As with any mortgage loan, borrowers must meet loan obligations: paying property taxes and homeowner's insurance and maintaining the home. They also must live in the home as their primary residence.

Four Facts About Reverse Mortgages

If you are considering a reverse mortgage, discover the following four facts you should know:

Interest rates are on par with traditional mortgages.

Contrary to popular belief, interest rates on reverse mortgage loans are not higher than rates on most traditional loans. Interest only accrues on money borrowed. If you set up a reverse mortgage but don't use it or only take some of the proceeds available, no interest is paid on the unused portion.

You cannot lose your home simply by having a reverse mortgage.

Reverse mortgages are federally insured and one of the most heavily regulated mortgage products on the market today. Borrowers cannot lose their home so long as they comply with loan responsibilities of paying taxes, insuring, maintaining the home and occupying it as the primary residence.

In 2015, the U.S. Department of Housing and Urban Development (HUD) implemented the financial assessment, which requires reverse mortgage lenders to review a prospective borrower's credit, income and their ability and willingness to comply with loan terms. This review has resulted in a massive drop in the rate of foreclosures on reverse mortgage borrowers.

Other recent guideline changes and safeguards were also put in place, with the most recent improvements implemented in 2017. As a result, the reverse mortgage is one of the most well-developed and heavily regulated products in the mortgage industry.

The bank does not take the home when you die.

You are free to leave the home to whomever you wish. If your heirs wish to keep the home, they will need to pay off the reverse mortgage balance. If they sell the home, the reverse mortgage is paid off through the proceeds of the sale with any remaining equity being passed on to your loved ones.

You may make payments or choose to defer payback until leaving the home.

Reverse mortgages offer a way to monetize your home equity to supplement retirement income, fund care needs, improve your home, increase cash flow and stretch retirement savings.

You can set up a reverse mortgage as a line of credit to hold in reserve until you need it. The line of credit can be set up at very little cost, is federally insured and can never be suspended, frozen or reduced regardless of what happens to the home value or market conditions so long as the terms of the loan are met.

Many people don't think of reverse mortgages this way, but more and more financial advisors are recommending their clients use this strategy to maximize retirement income.

One of the most popular ways that reverse mortgages are used is to increase cash flow by converting a traditional mortgage to a reverse mortgage, eliminating the mandatory mortgage payment. Other clever homeowners are optimizing their investment portfolios by using home equity, thereby preserving assets with higher growth potential.

Reverse mortgages aren't for everyone. Take ample time, explore your options and seek professional advice before deciding if a reverse mortgage is the right option for you.

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