What Is a Reverse Mortgage?

Many Americans facing retirement would love to increase their monthly income.

Faced with fixed pensions, rising medical expenses, limited Social Security benefits, and longer life spans, an increasing number of people are actually being forced to lower their standards of living when they retire.

As you approach retirement, one of your major assets is likely to be your house. By the time the average person retires, his or her home is usually worth significantly more than he or she paid for it.

Now there are techniques that will enable you to use your property to finance your lifestyle without the emotional trauma of having to sell your home.

Reverse mortgages effectively allow you to annuitize your house. All borrowers must be at least 62 years of age for most reverse mortgages. You may decide to receive a fixed monthly payment for the rest of your life. This is tax-free because it comes in the form of a loan. You don’t even have the worry of repaying the money. It is only due upon the death of the surviving spouse with the sale of your property.

Owners generally must occupy the home as their principal residence (where they live the majority of the year).

The monthly payment you receive is computed using standard annuity methods that take into account your age and life expectancy. In addition, the current and projected future value of your property and the amount of equity in your house that you wish to assign to the loan company are considered.

For example, you may choose to take the loan against only 50 percent of the equity stake in your house. This would obviously cause a reduction in the size of your monthly check.

All reverse mortgages turn your home into three things: loan advances paid to you; loan costs paid to the lender and others; and leftover equity, if any, paid to you or your heirs at the end of the loan.

If property prices decline after you take out the loan, it will not affect the remainder of your estate. In such circumstances, the lending company bears the loss. This is similar to a traditional annuity in which the insurance company bears the loss of continuing annuity payments in the event that you live past your life expectancy.

You do need to exercise some caution before undertaking a reverse mortgage. As you continue to own your home, you are still responsible for property taxes, insurance, and repairs. There are costs associated with a reverse mortgage that can include an application fee, closing costs, and a monthly servicing fee. The federally insured Home Equity Conversion Mortgage is generally less expensive than other private-sector reverse mortgages. You should carefully consider the costs and consult with a professional who can explain the full implications. If you decide to back out of the contract, the surrender charges can be very steep.

If they fit in with your temperament and lifestyle objectives, reverse mortgages can be an alternative tax-free means of increasing your monthly income during your retirement years.