Reverse Mortgage may be Best Choice for Tapping Home's Value

by Lynn O'Shaughnessy

When Americans try to figure out their net worth, they often find that their biggest chunk of wealth isn't stashed in a bank or a brokerage account. For many of us, our true wealth can be found in our porcelain sinks, wallpapered bedrooms, outdated kitchens and scuffed hardwood floors. Our homes, particularly in states like California, New York and Florida, are often our most valuable asset. Knowing that a house has turned into a personal cash register can be comforting. But at the same time, plenty of homeowners become frustrated because the cash value of their homes may seem as accessible as the gold bars stored at Fort Knox. Traditionally, you faced two alternatives if you needed to mine your home-equity gold. You could box up a lifetime accumulation of stuff and sell the family house. Or you could extract cash through a home equity loan. If you flinch at either of these options, it's only natural. You may be unwilling to leave behind the place where your children celebrated every birthday and lost their first teeth. And if you take out a loan, the lender will expect regular payments, which could be difficult if your cash flow resembles a dried-up creek bed. An increasing number of Americans, however, are now turning to Plan C. These folks are withdrawing money from their homes without worrying about paying it back. And the borrowers get to remain in their homes. You can pull off this feat by obtaining a reverse mortgage. With one of these mortgages, you can extract equity out of your home and the withdrawals won't have to be repaid until you sell your house, move out of your residence permanently, or die. Reverse mortgages aren't available to just anybody. You have to be at least 62 years old to qualify. For couples, both spouses need to meet the age requirement. So if a husband's 68 and the wife just turned 61, the deal's off, at least for a year. On the other hand, you may be eligible for a reverse mortgage even if you're still a slave to those monthly mortgage payments. You'd have to use cash from the reverse mortgage, however, to pay off your original lender. In the past, reverse mortgages rightly deserved a rather shaky reputation. The payouts were poor and the fees were outrageous. But you can credit the Federal Housing Administration for giving the reverse mortgage an extreme makeover. The FHA now insures about 90 percent of all reverse mortgages through what's called Home Equity Conversion Mortgage, or HECM, loans. Perhaps most importantly, the FHA standardized the lending process and set limits on how much these loans can cost. Consequently, a person seeking a reverse mortgage in Billings, Mont., should be able to get the same sort of loan as a homeowner living in Philadelphia or Los Angeles. Understandably, reverse mortgage lenders won't let you siphon your house dry. Some equity must remain in the house. How much cash you can access will depend upon your age, current interest rates and your home's value. The older you are, the more money you can tap. And the owner of an estate perched above the Pacific Ocean can pocket more than a fixer-upper in Oklahoma. House-rich Californians, however, can't walk away with as much money as you might imagine. That's because reverse mortgage lenders impose standardized caps that will essentially prevent people on the East and West coasts from overdoing it. When you obtain an HECM loan, for instance, the calculations are based on the value of a home not exceeding $362,790. That figure is intended just for high-cost areas. For a home located in a rural setting, the maximum value is set at $200,160. If you're curious about how much money you could pull out of your house, check out AARP's reverse mortgage calculator at www.rmaarp.com. I used the calculator to run my own sample projections. I assumed that a husband and wife, both age 68, own a house in San Diego that's worth $550,000. Here's the estimate that the calculator provided: The couple could pull out $197,601 in a lump sum, or have that same amount available in a credit line, which is the most popular choice. They could also elect to receive a monthly payment of $1,267 for as long as they live in their house. If the homeowners were 72 years old, the monthly payments would jump to $1,431 and the lump sum would increase to $213,404. It should take you less than a minute online to run your own numbers. If a reverse mortgage sounds intriguing, you'll obviously want to make sure you're tapping into your equity for the right reasons. You wouldn't want to exchange your equity for poker chips that are frittered away on frivolous purchases. There are endless legitimate reasons to make this move, including paying for medical costs and retrofitting your home so you can continue living there.What you should NOT do is plop this freed-up cash into an annuity. If you've been a guest at a free dinner that's hosted by an insurance agent or somebody else who lives off commissions, you may have been brainwashed into believing that using a reverse-mortgage windfall to buy an annuity is a no-brainer. At least, the agent's spiel sounded brilliant while you were tearing into your sirloin steak. Taking out a reverse mortgage to purchase an annuity, however, is like huddling under an umbrella in your living room when it's raining outside. In other words, it makes no sense at all. If what you desire is a monthly check, which some annuities provide, a reverse mortgage already offers that option. A reverse mortgage can also help your cash reserve grow. Let's go back to that example of the 72-year-old couple, who had the option of obtaining a credit line of $213,404. If they didn't touch this cash, based on current rates, the amount would grow to $302,828 in five years and mushroom to $429,724 at the end of 10 years. You certainly don't need to attempt achieving the same kind of returns with a costly variable annuity or equity indexed annuity, which can carry hideous surrender charges. If you want to learn more about reverse mortgages, read "Home Made Money, A Consumer's Guide to Reverse Mortgages." You can obtain a copy of AARP's free 52-page guide by calling the organization at 800-209-8085 or downloading it from www.aarp.org. Copley News

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