FIVE IMPORTANT QUESTIONS TO ASK

Do you really need a reverse mortgage? Why are you interested in these loans? What would you do with the money you would get from one? Are the needs you intend to meet really worth the high total cost of these loans? If you want to take a dream vacation, a reverse mortgage is a very expensive way to pay for it. Investing the money from these loans is an especially bad idea, because the loan is highly likely to cost more than you could safely earn. If anyone is trying to sell you something and recommending you use a reverse mortgage to pay for it, that's generally a good sign that you don't need it and shouldn't be buying it.

Can you afford a reverse mortgage? These loans are very expensive, and the amount you owe grows larger every month. The younger you are when you take out a reverse mortgage, the more the compound interest will grow, and the more you will owe. On the other hand, due to high up-front costs, these loans can be especially costly if you sell and move just a few years after taking one out.

Can you afford to start using up your home equity now? The more you use now, the less you will have later when you may need it more, for example, to pay for future emergencies, health care needs, or everyday living expenses. This is especially so if your needs suddenly grow or your income does not keep pace with inflation. You may also need your equity to pay for future home repairs or a move to assisted living. If you are not facing a financial emergency now, then consider postponing a reverse mortgage. Homeowners who decide to wait have "a reasonable expectation of securing a better product at a lower cost in the not-too-distant future,"" according to a report by the Fidelity Research Institute.

Do you have less costly options? Do you have other financial resources that you could use instead of taking out a loan? If you don't, and if you could easily make the monthly repayments on a home equity loan or home equity line-of-credit, these alternatives are much less costly than a reverse mortgage. Many state and local governments offer very low-cost loans for paying your property taxes or making home repairs. Have you seriously looked into the costs and benefits of selling your home and moving to a less expensive one?

Do you fully understand how these loans work? Reverse mortgages are quite different from any other loans, and the risks to borrowers are unique. Before considering one, you need to do your homework carefully and thoroughly.

10 THINGS YOU SHOULD KNOW

Q: What is a reverse mortgage? A reverse mortgage is a special type of loan that allows you to borrow against the equity that you've built up in your home. You must be at least age 62 to qualify. You can put the money toward anything you like, from paying medical bills to making home improvements. Unlike a traditional home equity loan, a reverse mortgage doesn't need to be paid back immediately, perhaps not even during your lifetime. That means no monthly checks to write to your lender. The HECM reverse mortgage program is run by the Federal Housing Administration (FHA).

Q: Can anyone apply for a reverse mortgage? No, you have to be at least 62. You also have to own your home outright or be able to pay off your home with the proceeds from a reverse mortgage. You must live in your home and your home must meet certain criteria according to HUD. Most single-family homes qualify, as do some condominiums, manufactured homes and multiunit structures that meet FHA requirements.

Q: How do I apply for a reverse mortgage? You can get a reverse mortgage through a traditional lender, just like you would for a regular mortgage. Before you get a reverse mortgage, you must meet with a reverse mortgage counselor, and there is a fee associated with that consultation. Usually, that cost (around $125) is rolled into the loan. You can receive the reverse mortgage in a lump sum, a line of credit or monthly payments. The loans are available in adjustable and fixed interest rates. In fact, more than 70 percent of the loans are now fixed-rate loans, which require you to borrow the maximum amount against your home's equity.

Q: Do I still need to pay my property taxes and home insurance with a reverse mortgage? Yes. Reverse mortgages are not like regular mortgages in which insurance and taxes are paid out of an escrow account, so you would have to pay those expenses. If for some reason your homeowner's insurance has lapsed, you will need to reinstate your policy. You also need to be current on any homeowner's association fees.

Q: When do I have to pay back a reverse mortgage? When you die, move or sell your home. The loan also becomes due if you default on the loan by not paying your property taxes or homeowner's insurance, or if the property conditions deteriorate and necessary repairs are not made.

Q: Are reverse mortgages expensive? There are substantial upfront fees (i.e., mortgage insurance premiums, loan origination fees and closing costs) with these loans, as well as ongoing fees (mortgage premiums, interest and servicing fees), during the course of the loan. Before you take out the loan, you have to consider how much you will shell out in fees so you have enough to cover your expenses.

For example, the standard HECM loan charges a 2 percent mortgage insurance premium up front on the home value – not the amount borrowed – as with regular forward mortgages. For example, if you own a $400,000 home, the upfront MIP would be $8,000 – whether you borrow $30,000 or $200,000.

Q: Is there a cheaper alternative to a standard HECM reverse mortgage? The new HECM Saver loan, which debuted in October 2010, charges only 0.01 percent of a home's value up front. The loan has some restrictions, however. The HECM Saver usually carries a higher interest rate and you can't borrow as much as you can with the HECM Standard. The amount you're allowed to borrow depends on your age. Both HECM Saver and HECM Standard loans require borrowers to pay mortgage insurance premiums on an ongoing basis equivalent to 1.25 percent annually of the outstanding loan balance.

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Q: What's the best age to take out a reverse mortgage? Although people are eligible at 62 to apply for a reverse mortgage, AARP policy expert Donald Redfoot says people should postpone getting a reverse mortgage as long as they can to ensure that they will have money later in life for needs like long-term care. Recent HUD data show the average age of borrowers has decreased from 77 to 73 years. "Getting rid of a mortgage may seem like a good idea by freeing up income, but borrowers need to understand that they are trading future savings for current consumption," Redfoot says. "Those who borrow early in retirement risk not having that equity available later in life when they may need it."

Q: What are the alternatives to a reverse mortgage? "These loans serve a particular niche, but they are not for everyone," Redfoot says. Before choosing a reverse mortgage, you should consider other options, such as selling your home. You could use the proceeds to downsize to a smaller (and cheaper) residence, or you could rent. If you want to stay in your home but need help making ends meet, think about getting a roommate. Start with family members or friends with whom you're compatible. Besides financial relief, a roommate offers companionship and can contribute to the upkeep of your home. Depending on the value of your home, you might be able to refinance your mortgage, or take out an equity loan or line of credit.

Don't forget to explore the availability of public benefits. For example, if someone has major health care or long-term care needs and a low income, they may be eligible for Medicaid assistance.

Use caution when choosing reverse mortgages.

Here's the problem: These loans can still be expensive. In addition to the up-front premium, HECMs impose annual insurance costs equal to 1.25 percent of your loan's value. Other up-front fees may total thousands of dollars.

If you plan to move within a few years, a reverse mortgage may not be worth the costs. Before agreeing to a reverse mortgage, consider other alternatives such as downsizing, refinancing, or arranging a loan privately with a family member, using your home equity as collateral.

The Risks: One of the upsides of a reverse mortgage: You don't make payments to a lender. But you can still default on the loan if you fall behind on your property taxes, homeowner's insurance, or homeowner -association fees, or if you fail to keep your home in good repair. As of March 2010, the federal government reports, more than 20,000 reverse-mortgage borrowers were in default on HECM loans. And if you default, you could lose your home.

Who pays the deceased's mortgage?

Q. My father took out a reverse mortgage before he married his new wife. Now that Dad has died, who is responsible for paying off the reverse mortgage?

A. Whoever inherits the house—most likely the spouse—must pay off the reverse mortgage, which becomes due when the borrower dies. Interest continues to be charged on the unpaid loan balance, so it's to the heir's advantage to repay the loan as soon as possible.

The home would have to be sold only if neither his estate nor his widow could arrange to refinance or take out a new reverse mortgage.

Reverse Mortgage Checklist

1. Make sure a reverse mortgage is right for you: Talk to a CPA, financial planner, or elder-law attorney.

2. Shop around. Some lenders are reducing or even waiving origination and servicing fees.

3. Get an estimate of how much you can borrow at our reverse mortgage

Reverse Mortgages

5 Questions To Ask Before Considering a Reverse Mortgage

&

10 Things You Should Know About Reverse Mortgages

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