Mortgage Choice

Better choices for a better life

Understanding reverse mortgages

If you are looking to borrow money in retirement, a reverse mortgage may allow you to use the existing equity in your home to act as security for a new loan, rather than relying on a regular income stream.

How does a reverse mortgage work?

A reverse mortgage allows you to take a loan as a lump sum, an income stream or a line of credit without having to make repayments while you live in the home.

Like a normal loan, interest continues to be charged on the sum, but unlike a normal loan, a reverse mortgage (including interest and fees) is usually repaid in full when your home is sold, you pass away or, most commonly, you move into aged care.

How is interest charged?

Although you will not have to make regular repayments to the loan, interest and fees are added to the loan amount each month and that interest compounds. This means that in addition to the balance you borrow, you will also pay interest on the interest and the fees or charges that are applied to the loan. Interest rates on a reverse mortgage are also typically higher than for a standard loan.

As a result, the amount you owe the lender will increase over time. This table demonstrates how a reverse mortgage of $50,000, and the impact of compound interest over 10 years, can leave you owing more than twice that original amount.

Loan Term	Interest	Total amount owing
1 year	$4,420	$54,420
2 years	$9,230	$59,230
10 years	$66,632	$116,632

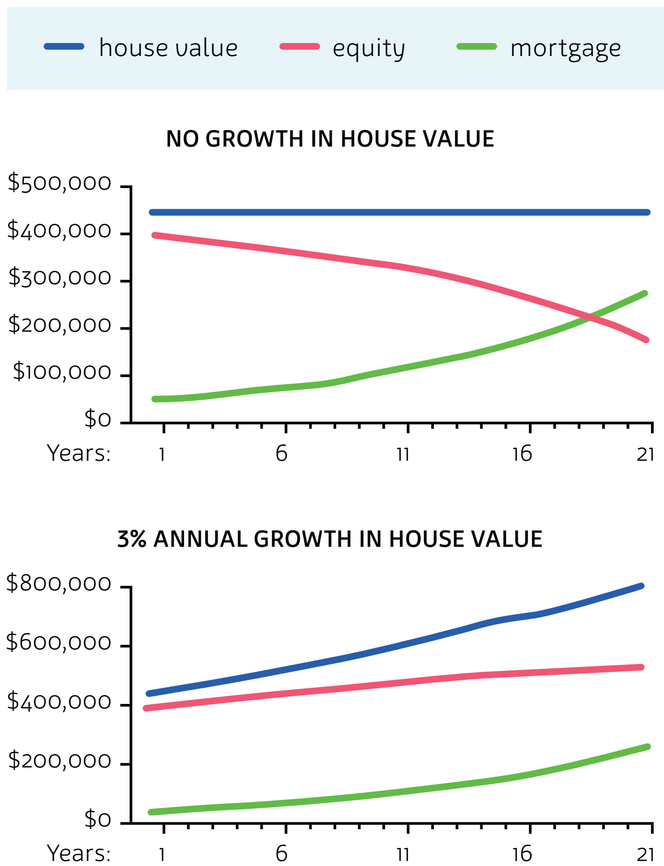
This table assumes a fixed rate of 8.5% p.a. compounded monthly with no fees applying and no repayments being made.

Once a reverse mortgage is paid, what will you be left with?

Let's say the value of your home is $450,000 when you take out a reverse mortgage of $50,000. Over 20 years, your debt will grow from $50,000 to $272,060.

At the time you leave your home, if its value has not increased, you will have $177,940 remaining once the loan has been repaid.

If the value of your home had gone up at a rate of 3% per year over 20 years, your home would then be worth $812,750. Once the loan was repaid, you would have $540,690 remaining.



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Deciding if a reverse mortgage is right for you

How will the loan affect my financial future?

The younger you are when you take a reverse mortgage, and the more you borrow, the less equity you will have in the future. It's important to consider how your needs may change in the next 10, 20 or 30 years. Using too much of your equity too soon may impact your ability to afford future costs such as medical expenses or the need to move into aged care accommodation.

How much will I need to repay?

The amount you finally repay can only be estimated. It will depend on how much money you borrow, the interest rate and length of the loan, as well as the value of your home when it is sold.

Could I owe more than my home is worth?

By law, lenders must guarantee that when your reverse mortgage contract ends and your home is sold to repay the loan, you will not have to pay back more than the value of your home. This is known as a "no negative equity guarantee". There are a few exceptions to this rule.

Can other people continue to live in the home?

If you are the homeowner and someone else is living with you, the other resident may have to move out when you no longer live there (for example you move into aged care) and the loan has to be repaid. Some reverse mortgage contracts may protect the rights of the other resident by allowing them to stay in the home, however you will need to discuss this with your lender before taking out a reverse mortgage.

Will I still be able to leave my children an inheritance?

A reverse mortgage reduces the amount of equity left in your home. You may wish to discuss this with your family.

Are there any other alternatives?

There may be more appropriate alternatives suited to your needs. These include downsizing, making arrangements with family members, accessing government benefits, loans (such as the pension loans scheme), using savings, selling other assets or home reversion schemes.

Are there costs for repaying the loan early?

Break costs may apply when a fixed interest reverse mortgage is ended early. Break costs can be very high - even thousands of dollars - depending on the size of the loan and how long you have had it.

Will a reverse mortgage affect my pension?

A reverse mortgage may affect your pension or other Government entitlements. You can contact the Department of Human Services (Centrelink) on 132 300 to talk to a Financial Information Service Officer about how your pension may be affected.

Want to know more?

ASIC's MoneySmart website is a great resource to find out more about reverse mortgages, including a reverse mortgage calculator to help you work out how much equity you may have in the future. Visit the Australian Securities and Investments Commission's free consumer website at www.moneysmart.gov.au or call 1300 300 630.

When considering a reverse mortgage, there are many factors to consider, so it's definitely worth speaking with your local Mortgage Choice broker about your options. We understand the different requirements of each lender, and can help you cut through the clutter to find the loan that's right for your needs. We can also put you in touch with our financial advisers to help work out if this is the right move for you now, and in the future.

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