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Reverse Mortgages

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Reverse Mortgages
by: Rona Birenbaum CFP

Q: I have heard mixed reviews regarding reverse mortgages. The ads make it look so enticing, but my friends are telling me it’s a bad idea. What do you think?

A: I know that it sounds great….tax free cash, the loan (and loan interest) only gets repaid when you sell your home, the loan will never exceed the value of your home etc. etc. But I believe that a reverse mortgage should be a last resort for funding retirement cash flow needs

I am sure that you have heard about the power of compound interest. The power of compound interest is what grows money exponentially over time. This same power is what erodes the value of an asset (your home in this case) when the interest being compounded is loan interest.

A reverse mortgage works like this. You have a house that you own with little or no mortgage. A reverse mortgage lender will typically provide you with up to 50% of the equity in your home. The current 5-year rate from the Canadian Home Income Plan website is 5.95%. At this rate of interest, in 15 years time, a $100,000 loan will balloon to almost $241,000. Based on current rates, if you borrow the maximum 50% permitted under the CHIP program, and your home equity continues to grow at the long term average of 4%, your home equity will be completely used up within 15 to 20 years.

A reverse mortgage may or may not be suitable for you. Just make sure that you are considering all possible solutions to your cash flow needs, keeping debt to an absolute minimum.

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