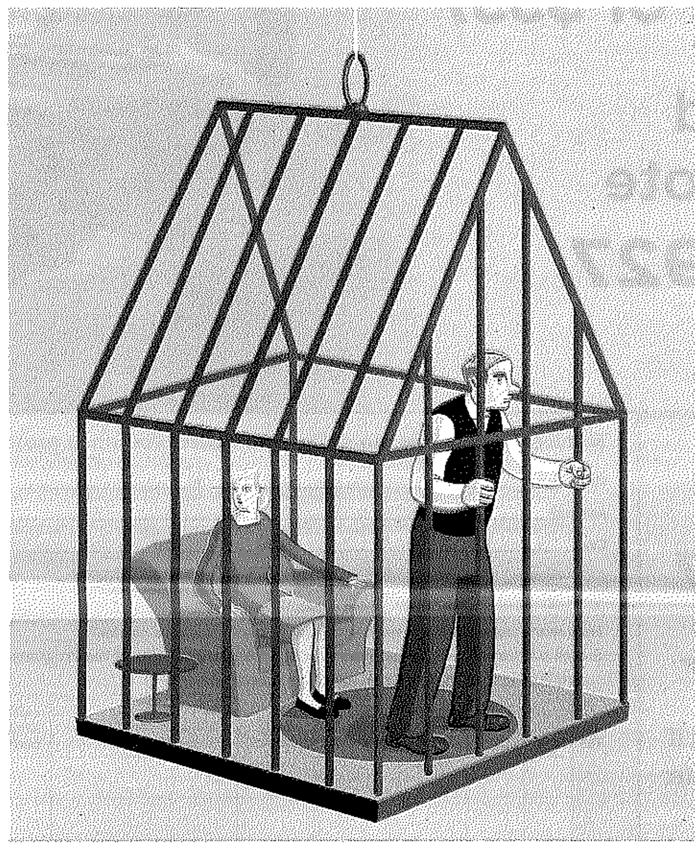
Beware the pitfalls of taking a reverse mortgage too early

'Tax-Free' and Other Catnip

By Jane Bryant Quinn



Reverse mortgages are attracting a younger crowd. Originally they were designed to help cash-poor older people stay in their homes, as a loan of "last resort." But boomers ages 62 to 64 now represent 20 percent of prospective borrowers (62 is the earliest age you can apply), according to a recent survey by MetLife Mature Market Institute. Nearly half the people considering a reverse mortgage today are under 70.

One reason for the change might be the TV-ad blandishments of celebrities such as Fred Thompson and Robert Wagner. Thompson, in his trustworthy *Law & Order* voice, describes reverse mortgages as "safe" and "effective," not to mention (in words I call American catnip) "tax-free cash" and "government-insured." Wagner temptingly calls reverse mortgage loans an "easy first step toward enjoying life more fully."

MetLife has a different take: The steep recession pressed especially hard on early retirees and others past midlife who might have lost their jobs and are motoring through their savings. They're turning to reverse mortgages to pay bills or replace a traditional mortgage whose payments they can't afford.

But when you've used up the money you borrowed, what's next? These "safe" loans can lead you straight to foreclosure in your later years.

A reverse mortgage is a loan that allows a homeowner to convert home equity into cash. No repayments are due as long as you live in the house. When you leave it—normally, at death or because you choose to move, say, to assisted living—the house is usually sold. The sale proceeds go toward covering the loan plus all the substantial fees and interest that have accrued over the years. Any money left over (a big "if") goes to you or your heirs. If the house sells for less than what you owe, no problem. You pay nothing more. In most cases, the lender's insurer (the federal government) swallows the loss.

All these guarantees make the loans sound as safe as Fred Thompson promises. But there's something he overlooked. You can keep the house only as long as you can pay your property taxes and homeowners insurance. If you run out of money and let these bills slide, you're in default, and the bank can foreclose on your house.

These 'safe' loans can lead you straight to foreclosure in your later years.

About 46,000 reverse mortgages are in default—8 percent of the total, says the U.S. Department of Housing and Urban Development. So far, 61 percent of the troubled borrowers are in repayment plans. Still, lenders won't let defaults accumulate indefinitely. You'll likely see foreclosures rise toward the end of this year.

It's bad public relations to throw Granny out of her house, so banks are getting choosier about making loans. In the past, you could get a reverse mortgage without a credit check. Now, you might have to show that you'll still be able to pay your bills when the reverse mortgage money runs out. If the banks turn you down, consider it a timely warning. To avoid eventual foreclosure, sell your home now, grab whatever home equity you still have, and make other living arrangements.

If married couples decide to take a reverse mortgage, be sure you're both on the loan. That way, either one of you can remain in the house without repaying the loan if the other spouse dies or enters assisted care.

Under current HUD policy, spouses who aren't on the loan are forced to repay if they want to keep the house. If they don't have the necessary assets, the home is sold out from under them. AARP considers this a misreading of the law and has filed a lawsuit, according to AARP senior attorney Jean Constantine-Davis.

If the spouse or other heirs do want to buy the house, they owe the lesser of either the total loan amount or 95 percent of the home's current market value. Some lenders have tried to charge relatives the full amount of the mortgage balance, including all fees—even if it's more than the house is worth. So know your rights. For details, go to hud.gov and enter "reverse mortgage" in the search box. Be warned that it's a high-cost loan, especially if you borrow in your 60s.

But here's an interesting thought for people in their 70s who have a substantial nest egg: You might use the income from a reverse mortgage to reduce the amount you have to withdraw each month from your savings. That leaves you with more liquid money invested for growth, which could help you pay the bills for many years more. □

Jane Bryant Quinn *is a personal finance expert and author of* Making the Most of Your Money NOW. *She writes regularly for the* Bulletin.