THE WALL STREET JOURNAL SUNDAY.

NEXT

Advisers Reverse Thinking on Reverse Mortgages

By Tom Lauricella

Using your nest to help with your nest egg is becoming a more common way to round out a financial plan during retirement.

Even after the bursting of the housing bubble, the biggest financial asset many retirees have is their home. But because that money is tied up in the equity of the house, it's an investment that has been difficult to count on as a source of income.

Reverse mortgages have long been an option. However, until recently, they were the Wild West of retirement planning. High upfront costs, poor disclosure and dodgy sales pitches made them an option that many advisers avoided.

Now, with the introduction of reverse mortgages backed by the Federal Housing Administration in late 2010, more financial planners are adding them to their tool kit.

Primarily, they're using them as a way to provide a steady stream of tax-free income that can last the rest of a retiree's life. They can also be used as a way to provide a cushion against a big, but temporary, drop in the markets.

"Between Social Security and a reverse mortgage, for some people there might be enough money to cover their needs-based expenses," says Mark Cortazzo, senior partner at Macro Consulting Group, a financial advisory firm in Parsippany, N.J. "Then you can use a portfolio, or maybe a part-time job, to cover the 'wants.' "

While any financial-planning decision should be thought through, a reverse mortgage literally involves the roof over your head. Take the time to understand the implications of a reverse mortgage, the costs and the different options. "It's a tool...but it's something that people need to be careful with," says Mr. Cortazzo.

Borrowers need to be sure they will have enough money in future years to pay real-estate taxes and homeowners insurance, or otherwise face possible eviction. Married couples should be sure both names are on the mortgage to avoid a situation where after the death of the sole spouse named on the loan, the surviving spouse has to pay off the loan. And retirees should be wary of brokers pushing higher-fee reverse mortgages.

Dieter Braun

A reverse mortgage is essentially a loan that allows the owner of a house or condo to convert some of the equity in the property into cash. Such mortgages differ from a traditional loan in that the money doesn't need to be repaid until the home is sold or no longer used as a principal residence.

Retirees can receive a steady stream of tax-free income for the rest of their lives.

Another major difference is that there are no credit and income requirements. These mortgages can be set up to pay out all at once in a lump sum, on a monthly basis or as a line of credit. (Details can be found at the website of the Department of Housing and Urban Development. Go to hud.gov and search for "reverse mortgage.")

One of the quirks of reverse mortgages that makes them appealing for a financial plan is that when set up on a monthly basis, over a period of many years a homeowner could receive more money in payouts than the house is worth at the time of the loan.

Roberto Nascimento, director of reverse mortgages at Arlington Financial in Yonkers, N.Y., takes the example of a 66-year-old with a house valued at $340,000. After subtracting the closing costs on a low-cost, FHA-backed floating-rate reverse mortgage known as a "Saver," that retiree could get a loan for about $173,000, which translates into a monthly check of $1,006 for the rest of his or her life.

By age 86, the payouts would have totaled more than $240,000; after another decade, the total would be $360,000. A "standard" reverse mortgage, with higher closing costs, would pay out $414,000 over 30 years.

Financial planner Harold Evensky, in Coral Gables, Fla., is taking a different tack with reverse mortgages. He has long recommended retirees keep on hand enough cash to meet two years of expenses, thereby avoiding having to sell investments at depressed prices during a bear market to pay the bills.

Mr. Evensky says that with a reverse-mortgage line of credit known as an HECM Saver, that cash bucket can be reduced to just six months. When things get ugly in the market, the retiree taps the equity line. When markets improve, he or she can sell investments and repay the loan.

The credit line is permanent, and the retiree won't have to start paying back the loan right away. In addition, the amount available to borrow will increase over time.

Mr. Cortazzo, meanwhile, points to an example where a reverse mortgage is being used to help keep the mother of one of his clients in her house and pay for the in-home care she needs. Not only does the reverse mortgage keep her in her house, her sons won't have to incur tax penalties by dipping into their retirement accounts to help pay for her care.

They just give up the possible future benefit of proceeds from selling the house. "That's the sweet spot," says Mr. Cortazzo.

Email: next@wsj.com

Financially Speaking

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 rever gage money runs out. If the ba you down, consider it a time ing. To avoid eventual foreclo your home now, grab whatev equity you still have, and ma living arrangements.

If married couples decide reverse mortgage, be sure you on the loan. That way, eithe you can remain in the house repaying the loan if the othe dies or enters assisted care.

Under current HUD policy, who aren't on the loan are f repay if they want to keep th If they don't have the neces sets, the home is sold out fro them. AARP considers this a ing of the law and has filed a according to AARP senior Jean Constantine-Davis.

If the spouse or other heirs to buy the house, they owe t of either the total loan amou percent of the home's curre ket value. Some lenders ha to charge relatives amount of the mort ance, including all fe if it's more than the worth. So know you For details, go to hud enter "reverse mort the search box. Be that it's a high-cost pecially if you borrow in your 60s.

But here's an interesting thought for their 70s who have a substantial nest might use the income from a reverse n to reduce the amount you have to w each month from your savings. That le with more liquid money invested for which could help you pay the bills f years more. □

Jane Bryant Quinn *is a personal finan and author of* Making the Most of You NOW. *She writes regularly for the* Bull