Reverse mortgage is 'the last card' to play

Other options available to assure seniors keep their financial security

By Nancy Carr
Canadian Press

With real-estate values skyrocketing in many Canadian cities, stock markets in the dumps for years and uncertainty rising over pension payouts, a reverse mortgage seems to make sense for a retiree homeowner looking for extra income.

But despite the eager ads on TV and the allure of a loan you never have to pay off, a reverse mortgage is the "last card" a senior citizen should play, Vancouver financial adviser David Chalmers says.

Reverse mortgages, introduced in Canada in the mid-1980s and now available across the country to homeowners over age 62, let householders turn their home equity into cash without having to sell.

Unlike a regular mortgage, in which the loan decreases as the equity increases, the amount owed on a reverse mortgage increases while the equity decreases. Repayment isn't usually made until the homeowner dies or moves out of the house. At that point the loan comes due with interest, typically about three percentage points above the prime-lending rate.

About 5,500 Canadians have reverse mortgages. The principal amount averages 30 per cent of their home's appraised value. The older the applicant, the more equity can be used, with 40 per cent or $500,000 the maximum.

"What's good about [a reverse mortgage] is that, as they say in their commercials, you get an income for life, you're never forced to move out of your home, you can stay there as long as you want. There's just going to be a big charge against your home when you ultimately do move out or die."

"That's fine, but all you have really done is you have converted some of your children's estate into an income for you, which you can also do simply by spending money that you have or by converting money to an annuity."

The latter methods, Chalmers points out, don't involve new debt.

The Canadian Home Income Plan, which administers reverse mortgages, doesn't pretend this financial tool is for everyone. "There are a variety of reasons why it might not be the right choice," says Sian Owen, spokeswoman for CHIP.

For instance, it wouldn't be a good way to finance an expense like a new roof because a bank could probably provide a loan at a lower interest rate than the reverse mortgage, which is set at 7.5 per cent for this year.

But if staying in one's home is important, the reverse mortgage is worth consideration, she says.

Chalmers, whose clients are mostly of retirement age, agrees. He has placed only one reverse mortgage in his career, "because it fit like a glove for that particular client," he said.

"If you said to me, 'All I have coming in is old age security, guaranteed income supplement and I have this $700,000 home, but the most important thing to me is to stay in that home,' then I'd say a reverse mortgage is the solution," he said. "But, overwhelmingly, when we look at all of the considerations, there are better ways to accomplish the objective."

The Canadian Home Income Plan counsels seniors interested in a reverse mortgage to consult a financial adviser and let their children know what they're planning to do. Otherwise, heirs to what they thought was a house worth $500,000 could be in for a big surprise.

A reverse mortgage may appeal to a healthy couple in their 70s who imagine living the rest of their lives in their home. But it's not such a pretty proposition when one partner dies and the other wants to move, or if they both have to go into a nursing home.

"At that point it's just a complete shock and people say, 'If it's costing me that much already, it's not worth it for me to move,'" says financial planner Alan Hoffman. "And then they're stuck in this home that really they don't want to be in anymore."

Hoffman is not a fan of reverse mortgages. "It costs you 2.5 times the value of your home to buy it from the bank when you use a mortgage, and in a reverse mortgage the bank buys it back from you for 10 to 40 per cent," he said.

"That doesn't make a lot of sense to me."

About the Canadian Home Income Plan and reverse mortgages

Concept: Enables homeowners to generate income by taking out a loan against their home. Unlike a regular mortgage, repayment usually comes only after the owner dies or the home is sold. Anyone who inherits the house must repay the loan and interest in full.

Conditions: Reverse-mortgage clients must be 62 or older. They can sell, move or repay at any time, but the loan and interest are due if they sell or move.

Cost: Currently 7.5 per cent annually.

Loan amount: From 10 to 40 per cent of home's appraised value. Limit is $500,000. Average applicant gets about 30 per cent.

Ownership: Title remains in the name of the owner. There is no penalty if the property loses value.

Popularity: About 5,500 Canadians have reverse mortgages. — Canadian Press