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reverse mortgages think carefully

The family home remains the single most important asset for many of our over-55s. The problem is that our homes lock up large amounts of capital, money that would be very handy in retirement. Reverse mortgages let seniors unlock this home equity without the need to sell up or move out of a much-loved property though the extra cash can come with a mounting interest bill.

The idea behind reverse mortgages is that older homeowners can cash out part of their home's value, with the funds received either as a lump sum, a series of cash payments or a combination of both. The money can be spent however the homeowner chooses be it to buy a new car, take a holiday or simply meet living expenses.

Not all lenders offer reverse mortgages. Among the list of current providers are St George and BankSA, the Commonwealth Bank, Newcastle Permanent and Suncorp. Interest rates vary widely and do tend to be higher than for standard home loans. At present you can expect to pay anywhere between 6.4% and 9.5% depending on the lender and loan.

A strong point of appeal with reverse mortgages is that no repayments are required until you sell the property or die. However interest is charged from day one so it doesn't take very long for the overall debt to escalate, potentially outpacing the increase in your home's value.

To see just how quickly the debt can snowball, let's say that a retiree aged 65 takes out a reverse mortgage, receiving an initial lump sum of \$50,000 at the start of the loan, with a further \$500 per month paid for the first five years. By the time the homeowner is in his or her mid-80s, the debt plus interest will have grown to \$400,000.

The mounting debt may alarm our hypothetical retiree's family members, who are likely to be left a smaller estate. But it should also be a concern to our homeowner.

That's because around 50% of both men and women currently aged 65 have a 50 per cent chance of living to their mid-80s. So if our senior has depleted \$400,000 in home equity by this stage, what will he or she live on for their remaining years?

It's a serious issue if nursing home accommodation is required at a later stage as this can bring significant funding costs.

To help seniors understand exactly how a reverse mortgages works, investment regulator ASIC has produced the booklet "Thinking of using the equity in your home?" It's a comprehensive guide for seniors, with some input from yours truly. Download a copy from ASIC's consumer website FIDO (www.fido.gov.au) or ASIC on 1300 300 630.

Paul Clitheroe's 'Making Money' for the week beginning 6 July 2009



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