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reverse mortgages – worth considering, very carefully

For many baby boomers, retirement will be a financial juggling act. Without the backing of compulsory superannuation contributions throughout their working life, many may consider a reverse mortgage as a source of additional retirement income.

A reverse mortgage provides an opportunity to access home equity, with the loan secured by your home. There are no repayments necessary until you a) sell up, or b) die – in which case the loan is repaid out of your estate.

You can choose to receive the cash from a reverse mortgage as a regular series of payments, a lump sum or a combination of both. A lump sum payment may be counted in the Centrelink assets test, so it could reduce your age pension entitlements.

To be eligible for a reverse mortgage you generally need to be aged 60 plus, and it's essential to own your home. You can usually borrow between 15% and 40% of the value of your home depending on your age. The older you are, the more you can borrow.

A reverse mortgage is an appealing way to tap into home equity, but these loans don't come cheap. The interest rate and fees are often

higher than those of a regular mortgage.

As a guide, the Commonwealth Bank charges an upfront fee of \$950 plus interest of 8.46% for its reverse mortgage, which is only available to over 65s. St George Bank's Seniors Access Loan (available if you're aged over 63) charges 8.43% with an upfront loan fee of \$950.

This is important because the interest on the loan builds from day one. The younger you are when you take out the loan, the less you'll have in home equity as time goes by – more so if home values rise slowly.

For instance, let's say a retiree owning a home worth \$400,000 takes out a reverse mortgage for just \$50,000 at age 65. We'll also assume that the loan rate is 8.5%, the monthly fees are \$12 (about the current average) and the upfront fee is \$900. If the property grows in value by 4% each year, by the time the home owner is aged in his mid-80s, the home will be worth around \$871,000 and the loan will have grown to about \$248,000.

This may not seem like such a bad deal – after all, there's still plenty of home equity left to draw on. The problem is that it's in later life

that we often have to fund aged care accommodation, and this can be very expensive. Once you've exhausted your home's value, there may not be much else to turn to.

Reverse mortgages are certainly an option for cash-strapped retirees to consider. And if you're worried about leaving less to the kids, think again. I'm sure no adult child would begrudge their parent a decent retirement even if it means leaving a smaller estate.

Nonetheless it's important to be aware of the long-term effects of using a reverse mortgage at an early stage of retirement. A good starting point for information is the consumer website of investment watchdog ASIC. The website at www.fido.gov.au provides a free booklet on reverse mortgages plus a handy online calculator that shows how the loan can impact your home equity over time.

Whatever you do, don't sign up for a reverse mortgage without getting independent professional advice from your accountant or lawyer.

Paul Clitheroe's 'Making Money' for the week beginning 23 August 2010



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