Is a reverse mortgage the way to go?

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Ralph and Louise have seen the TV commercials featuring Gordon Pape, the financial author, as the spokesman for Canadian Home Income Plan Corp. (CHIP) reverse mortgages. They were wondering if it would be a good way to go to help ease their current financial situation.

A reverse mortgage is simply an advance on the value of your home that accumulates interest. The accumulated debt does not need to be paid off until you die, sell the home or move out of the house. If you qualify, and are over age 62, you can get up to 30% of the value of your home and you can do whatever you want with the money.

According to the CHIP website, a reverse mortgage delivers the cash tax-free. Of course, if the money is used to invest and produce an income, some or all of that income will be taxable.

It is very important to understand the cost of a reverse mortgage before getting into one. The CHIP website states that there will be an administrative fee of about $1,300 to set up your plan. On top of that, you will be able to choose a term of 6-months, 1-year or 3-years to determine the interest rate on your loan. Rates, of course, will be subject to change at the end of the term. Interest is compounded semi-annually.

For example, if Ralph and Louise get a reverse mortgage for 30% of the value of their $250,000 house and choose the 3-year term (7.50% on 13 Sept. 2005), they would get $75,000 today to do as they please. Don't forget the $1,300 set-up fee. Louise, at age 62, has a life expectancy of about 24 years. At that time, assuming no change in interest rates, the amount owing will have grown to over $439,026.

In spite of escalating home values over the last several years, they haven't appreciated in value much more than the rate of inflation over long periods of time. If we assume an inflation rate of 3%, their home may be worth about $508,199 in 24 years. That leaves only $69,173 after paying off the loan.

The CHIP website states that 'if property values decrease, the amount to be repaid is never more than the fair market value of the property at the time it is sold.

There are other ways to get money out of their home than a reverse mortgage. Ralph and Louise can sell their home and buy something smaller. They may be better off getting a home equity line of credit and drawing funds only as they need them, usually at much lower interest rates.

Garth Turner, former federal revenue minister, said **a reverse mortgage 'is an ideal strategy if you hate your children.'**

This article is for informational purposes only and is not intended to give specific advice on reverse mortgages or home equity loans of any kind.

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