It may seem like the perfect solution for those who own their homes but struggle to meet the ever-increasing cost of daily living. The commercials on TV promise that a reverse mortgage allows you to use the value built up in your home to enjoy life. Everyone looks so happy that it almost seems too good to be true.

While reverse mortgages may not be an actual fraudulent scam, they are not exactly the dream solution that people often expect. Before committing to a reverse mortgage, it is vitally important that you understand the terms and how they will affect you now and in the future, including the impact on your estate plans.

Understanding Reverse Mortgages

If you have acquired a certain amount of equity in your house and you are over the age of 62, you may qualify to obtain a reverse mortgage. The equity you have in your home is calculated by taking the value of your house and subtracting any amounts you may still owe on the mortgage. For people who have lived in a home for a long time or who invested money from the sale of a previous home, the value of equity in their home might be their biggest asset.

Many people feel trapped or “house-poor” because they cannot spend the value of their equity unless they sell the house. This is why a reverse mortgage sounds so attractive. With a regular mortgage, you pay small amounts each month to obtain increasing ownership interests in a property. A reverse mortgage allows you to take out amounts of equity each month. You can get money to spend without taking out a second mortgage, which would require you to make additional monthly payments. But there are conditions that apply, and those can make a reverse mortgage a very bad deal.

Note That a Reverse Mortgage is a Loan

Whoever coined the term “reverse mortgage” was a genius when it comes to marketing. This term makes it seem like all you are doing is taking out some of the value that is tied up in your real estate. You can tell yourself that you’re just removing some of the money you once put into your mortgage.

But the situation is not that simple. A reverse mortgage is a loan. This means that you will be required to pay interest and fees. You are taking out a loan against the equity in your home, and your debt increases each month. Remember that the debt includes not only the cash you receive but also lender’s fees and interest. The interest continues to mount even if you receive money in one lump payment. It is possible to consume all the equity in your house and still owe additional fees and interest.

Home Ownership

One reason people like the concept of a reverse mortgage is that they still feel like they own their own home. However, it is crucial to remember that home ownership comes with many obligations. If you have a reverse mortgage, you are still liable for paying property taxes and insurance. You are required to keep the home in good condition because it serves as collateral for the loan. If you fall behind on any of these obligations, the lender might foreclose on the loan. In that case, it would probably be necessary to sell the house to pay off the loan.

A Reverse Mortgage Could Limit Your Future

Living Options

Generally, someone who takes out a reverse mortgage will not be expected to pay back the loan while they continue to live in the house. The debt becomes the responsibility of that person's estate once they pass away.

While the reverse mortgage holder can remain in their home, they may have considerable trouble if they want to move to something smaller or nearer to family, friends, or healthcare facilities. Moving can trigger a duty to repay the loan. If repayment uses up all the remaining equity, then there will be nothing left to put toward a new residence.

Alternatives May Be Better

Before agreeing to the terms of a reverse mortgage, it is important to understand the interest rate and fees that apply. They are often much higher than the fees and interest rates of other loans, which means that it might be a better option to take advantage of another option, such as a home equity line of credit.

It is also important to consider the impact a reverse mortgage could have on loved ones. If family members are living in the home, they might be required to move out when you pass away. You should also ensure that the terms of the loan include a non-recourse clause so that if the loan amount exceeds the value of the house, the lender will not be able to come after heirs to seek repayment.

What Do I Need to Know Before Taking Out a Reverse Mortgage?

A Comprehensive Estate Plan Can Help You Conserve Resources Now and In the Future

Decisions such as whether to take out a reverse mortgage should be made in conjunction with a complete estate plan. At The Nordhaus Firm, we work to protect clients with comprehensive plans to conserve assets and protect against unnecessary losses now and in the days to come. For assistance with any estate planning goals, schedule a free consultation with our team today.