Bateman Battersby
LAWYERS

Reverse Mortgages – How do they work? What are the risks?

For people contemplating how to fund their retirement, accrued personal savings, accumulated superannuation and, if eligible, the aged pension generally first come to mind. However, with the number of retirees increasing markedly and predictions that people will live longer in retirement than ever before many existing retirees have chosen to fund their retirement lifestyle by entering into a Reverse Mortgage to unlock the equity in their home.

What is a Reverse Mortgage?

A reverse mortgage is a type of home loan that allows you to borrow money using the existing equity in your home as security for the loan. Depending on the lender you deal with the loan can be taken as;

(a) a lump sum; or

(b) a regular income stream; or

(c) a line of credit; or

(d) a combination of all of the above options.

Like other loans interest is charged on the outstanding balance of the loan but you don't have to make any interest or principal repayments while you live in the home and the unpaid interest compounds and is added to your loan balance.

As you remain the full owner of your home you can stay in your home for as long as you want but must repay the loan in full when you sell your home or die, and in most instances, if you move into aged care. Generally, you need to be at least 60 to apply for a Reverse Mortgage and just like any other loan you'll be required to pay an application fee to your lender. Otherwise no income test is applied by the lender in order for you to qualify for a Reverse Mortgage.

How much can I borrow?

Interestingly, with a Reverse Mortgage the older you are usually the more you can borrow. While different lenders have varying policies about how much they will let you borrow, as a general guide, if you are aged 60 the maximum amount you can borrow is likely to be 15 – 20% of the value of your home. As a rule of thumb, you can usually add one per cent for every year that you are older than 60. As an example, if you are 75 the maximum amount you can generally borrow would be 30 – 35% of the value of your home.

If you have an existing mortgage on your property it will be a requirement of your lender that you discharge the amount that you owe on this mortgage from the proceeds of the loan advanced under the new Reverse Mortgage.

What are the risks?

There are a number of matters that you should consider when considering whether to obtain a Reverse Mortgage including that:

- Interest rates for Reverse Mortgages are generally higher than average home loans and are often up to 2% – 3% above standard home loan rates.
- The amount of money that you owe under the Reverse Mortgage can increase quickly as the interest compounds over the term of the loan.
- Consequently, you may not have enough money left to secure a place in an aged care facility or for your other future needs when your circumstances necessitate you selling your home.
- Anyone who lives in your home with you but who is not a co – owner of the property may have to move out when you die.
- If you choose to fix your interest rate when taking out the Reverse Mortgage then the costs to break this agreement with your lender can be prohibitively high.

How does the Law protect me?

Under current legislation it is mandatory for your lender to provide you with what is known as a "Reverse Mortgage Information Statement". This statement must include the following information;

(a) Details about how your Reverse Mortgage works.

(b) How the lender's costs are calculated.

(c) Things to consider before taking a Reverse Mortgage and contact details where you can obtain further information.

Your lender must also show you what the long-term impact of a Reverse Mortgage will have on the equity that you currently have in your home. They will do this by meeting with you to run through prospective Reverse Mortgage calculations using an approved Reverse Mortgage Calculator. These projections will illustrate the effect that a Reverse Mortgage may have on the equity in your home over time using various scenarios relating to different rates of interest and prospective house price movements.

Borrowers under Reverse Mortgages are also protected by a Negative Equity Protection which has been required to be contained in all Reverse Mortgage Product Contracts entered into after September 2012. In simple terms this means that you can never end up owing your lender more than your home is worth when it is sold. Accordingly, the maximum a lender will receive is the total of the proceeds from the sale of the property and you cannot be held liable for any amount of the debt in excess of this amount. For this scenario to arise it's likely that there would need to be a substantial increase in interest rates and/or a substantial housing downturn that seriously impacted on property prices.

Will my pension be affected?

The answer to this question depends on the manner in which you take the Reverse Mortgage loan advance and what you use it for. Under current Centrelink rules if you draw a lump sum from a Reverse Mortgage up to $40,000.00 is exempt from the Pension Assets test for up to 90 days but it is immediately subject to deeming under the Income Test until you spend the money.

How you spend the money will also determine whether your pension is affected or not. If for instance you decide to buy a new car or caravan then they may be considered as an asset and be included in the assessment of your pension entitlements under the Assets Test. If, however you use the loan advance to undertake home renovations or repairs or to take a holiday this expenditure is not means tested and therefore your pension would not be affected.

Who can I get advice from?

There are a number of avenues where you can obtain advice if you are considering entering into a Reverse Mortgage including;

(a) contacting us for independent legal advice;

(b) discussing your intentions with your family members, particularly your adult children as they may be able to offer alternative proposals to assist you financially.

(c) speaking with your accountant or financial advisor to find out what other alternatives may exist having regard to your current savings and investments.

(d) contacting Centrelink to fully ascertain the impact a Reverse Mortgage may have on your current Pension entitlements.

(e) accessing the Reverse Mortgage calculator on the Australian Government website www.moneysmart.gov.au to work out the impact different loan terms, property values and interest rates may have on the equity in your property.

There is no shortage of marketing material aimed at convincing older Australians to cash in on their home equity. Taking out a Reverse Mortgage can be viable option provided that you carefully consider the risks involved and get appropriate independent advice about how this type of product may impact your later years of retirement.

At Bateman Battersby we have substantial expertise in assisting and advising clients on Reverse Mortgages and other home equity release related products. If you need help to ascertain the benefits and risks involved please contact our accredited property specialists, John Bateman or Michael Battersby on (02) 4731 5899 or email us at property@batemanbattersby.com.au.