Kiplinger's
RETIREMENT REPORT
Your Guide to a Richer Retirement MAY 2007 VOLUME 14 NUMBER 5 $5.00

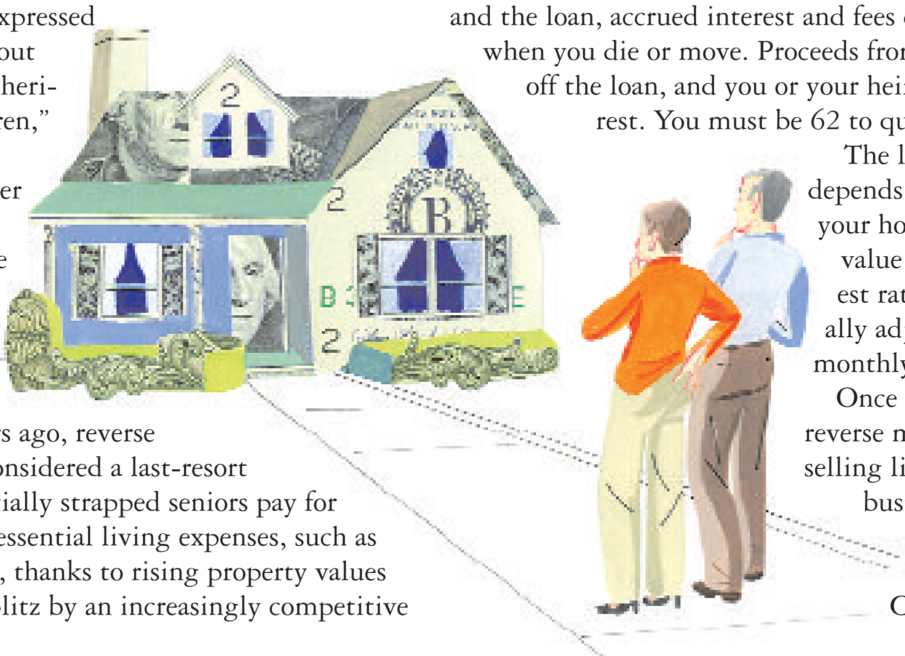
Turn Your Nest Into a Retirement Nest Egg

Reverse mortgages are on the rise, but be aware of the high costs as well as other drawbacks.

FIVE YEARS AGO, Bruce and Carol Carter turned their four-bedroom house in Boxford, Mass., into a retirement travel kitty. They took out a reverse mortgage of $180,000, periodically drawing on their credit line to visit Russia, Africa, Central America, Thailand and Europe. They've also used the money to pay property taxes on their home of 33 years and for home improvements, such as a remodeled playroom.

Most important to the couple, they've been able to help their three adult sons. For instance, Bruce, 69, a retired manager, and Carol, 68, who sells Tupperware, paid for an operation for their 34-year-old middle son, who had no health insurance.

"Some people expressed concerns to me about eliminating the inheritance to our children," says Bruce. "My advice is to consider the joy of seeing their lives improve now instead of having them fight over your bones later."



CHRIS SHARP

Only a few years ago, reverse mortgages were considered a last-resort tool to help financially strapped seniors pay for home repairs and essential living expenses, such as medications. Now, thanks to rising property values and a marketing blitz by an increasingly competitive industry, a growing number of older homeowners like the Carters are tapping their home equity to bankroll all sorts of pursuits.

Retirees are using these products to buy boats, start businesses, pay grandchildren's college costs and buy second homes. "As more homeowners take out reverse mortgages, there are more interesting angles," says Peter Bell, president of the National Reverse Mortgage Lenders Association, a trade group.

But just because you can use these loans to pay for a dream vacation doesn't mean you should. Although the costs of some products are dropping, they're still an expensive tool with all sorts of restrictions. Warns Ernest Hathaway, a certified financial planner in Midvale, Utah: "Reverse mortgages are like fire. They're wonderful if used properly with adequate precautions. But you can get burned easily if you aren't careful."

Growing by Leaps and Bounds

A reverse mortgage converts home equity into tax-free income. You can continue to live in the house, and the loan, accrued interest and fees come due when you die or move. Proceeds from the sale pay off the loan, and you or your heirs keep the rest. You must be 62 to qualify.

The loan amount depends on your age, your home's appraised value and the interest rate, which usually adjusts either monthly or annually.

Once relatively rare, reverse mortgages are selling like gangbusters. More than 85,000 Home Equity Conversion

Mortgages (HECM), the most popular kind of reverse mortgage, were made in 2006, compared with about 48,500 in 2005. With a HECM loan, the federal government will pay the lender if the proceeds from the sale of the house do not cover the loan and accrued interests and costs. These mortgages are capped from $200,160 to $362,790, depending on where you live. The rest are proprietary or "jumbo" loans offered by private lenders to owners of higher-priced homes. These loans are not federally insured and may have no limits on the loan amount.

The older you are, the more equity you can pull out. A 67-year-old who lives in a house in Chicago valued at $600,000 could get a $144,000 HECM loan while an 84-year-old would be eligible for $196,000. (Use the calculator at **www.rmaarp.com** to estimate your costs.) Interest on the loan is not tax deductible until the loan is paid off.

The baby-boomers' march to retirement is luring more firms into the market and driving current players to cut costs and add product features. Also spurring lower rates are moves by Ginnie Mae to start packaging reverse mortgages for sale on Wall Street. "We see more competition, many more products and a vastly increasing consumer base," says Joseph DeMarkey, vice-president of BNY Mortgage.

For instance, while just about all reverse mortgages use an adjustable rate, BNY recently started offering fixed-rate mortgages. Wells Fargo Home Mortgage just cut its variable-rate product by a half of a percentage point, which the company says translates into an extra $14,100 for a 70-year-old on a house worth $300,000. Meanwhile, Financial Freedom Senior Funding is selling a jumbo product with no origination fee or closing costs, but you need to draw at least $275,000 at closing.

In the years ahead, expect to be bombarded by lenders' appeals for you to tap your home's equity. As tempting as that may be, make sure you understand the pitfalls as well as the benefits. A financial planner or lawyer should read the contract before you sign.

Before You Pack Your Bags for Tahiti

A major consideration is the high costs. Closing costs and other non-interest charges, which are usually wrapped into the cost of the loan, can range from $25,000 to $50,000 on a house valued at $250,000, according to Kenneth Scholen, director of the AARP Foundation's Reverse Mortgage Education Project.

It's essential to compare the costs of several lenders because fees and closing costs vary. "Even if the costs are coming down, a reverse mortgage is still an expensive way to take a vacation," says Lisa Tatman, a certified financial planner with Financial Management Network in Mission Viejo, Calif. Because of upfront fees, don't take out a reverse mortgage unless you plan to stay in your home for several years.

If you consider a reverse mortgage, be sure to weigh the cost over the long term. According to figures provided by Financial Freedom, a 68-year-old with a $500,000 home could qualify for a HECM reverse mortgage with an initial line of credit of $211,566. (The credit line grows each year based on the untapped balance and the interest rate charged on the loan.) Assuming annual withdrawals totaling $352,000 over the next 16 years and an interest rate of about 6.5%, at age 84 the homeowner would owe $660,000, including accrued interest and fees.

If, at that point, the borrower needed to sell the house—to move to a smaller place or an assisted living facility, perhaps—the bill would come due. If the house had appreciated at 4% a year since the line of credit was established, it would be worth about $950,000. Still, after paying off the debt, our homeowner would have just $290,000. Would that be enough to finance the new home and other needs?

EDITOR IN CHIEF AND PUBLISHER
Knight A. Kiplinger
EDITOR
Susan B. Garland
ASSOCIATE EDITOR
Rachel L. Sheedy
CONTRIBUTING EDITOR
Christopher J. Gearon
EDITORIAL ASSISTANT
Amy M. Pollak
ART DIRECTOR
Mary Pat Doherty
DESIGNER
Beth Rosenfeld

MARKETING MANAGER
Todd W. Lebo

EDITORIAL OFFICES
1729 H St., N.W.
Washington, DC 20006-3938
TELEPHONE: 202-887-6491
E-MAIL: retire@kiplinger.com
FAX: 202-785-3648

SUBSCRIBER SERVICES
TELEPHONE: 800-544-0155
E-MAIL: sub.services@kiplinger.com
FAX: 515-246-1020

ADVERTISING SALES
Kristina Carrington
TELEPHONE: 917-421-9049
E-MAIL: kcarrington@kiplinger.com
FAX: 212-588-9201
CONTENT LICENSING
licensing@kiplinger.com
202-887-6558
REPRINT SERVICE
PARS International Corp.
102 W. 38th St., Sixth Floor
New York, NY 10018
TELEPHONE: 212-221-9595, ext. 322
E-MAIL: reprints@parsintl.com

Published monthly (ISSN# 1075-6671); $59.95 for one year; $89.95 for two years; $114.95 for three years. 1729 H St., N.W., Washington, DC 20006-3938.

Periodicals postage paid in Washington, DC.

POSTMASTER: Send address changes to Kiplinger's RETIREMENT REPORT, P.O. Box 3295, Harlan, IA 51593.

From the Editor

IN THE cover story on reverse mortgages, as in other stories, we suggest that you seek help from a financial planner. In many instances, all you may need is several hours of number-crunching to make sure that a certain course of action makes sense.

If you want a fee-only planner who won't sell you products, contact the National Association of Personal Financial Advisors (**www.napfa.org**; 800-366-2732) or Garrett Planning Network (**www.garrettplanningnetwork.com**; 866-260-8400).

Susan Garland

Susan B. Garland, *Editor*

This example assumes a level interest rate and steady appreciation of the home. What if adjustable rates rise or the value of the house falls? Federal rules ensure that you will never owe more than the value of your home. Still, if you need to sell before you die, you could find yourself with little equity left over to cover health-care costs and other living expenses. This is the kind of long-term view you need to take.

Before you can take out a reverse mortgage, you'll need to talk with a counselor approved by the federal Housing and Urban Development Department. Ask your counselor or lender to run through various scenarios—using different interest rates, loan amounts and home values—to figure out your leftover equity. Make sure the counselor or lender uses computer software based on AARP's model specifications.

Once you know the numbers, check for cheaper alternatives. Perhaps it makes better sense to move into a smaller house. Or maybe you should take out a home-equity line of credit and ask an heir to help make the payments. Some states provide low-cost loans to seniors who are making home repairs.

Ask a financial planner to compare the costs of a reverse mortgage with other financial tools. Say you're trying to raise money to buy a retirement home that you're not ready to move into yet. Assuming you can afford monthly payments, Hathaway says that it may be wiser to take a five-year adjustable-rate traditional mortgage on your current house. "It's cheaper to borrow money with a traditional mortgage than with a reverse mortgage," he says.

Still, Hathaway says, he's had clients take out a reverse mortgage to pay off a traditional mortgage. "They no longer have a mortgage payment that's a drain on their budget," he says. "They're still paying high fees, but to them it's worth it."

If you're choosing between an annuity and a reverse mortgage, note that reverse-mortgage payments don't count toward the threshold for determining whether Social Security payments are subject to income tax. But if you're receiving Medicaid, Supplemental Security Income or other public aid, reverse-mortgage payments could be counted as liquid assets for purposes of deciding eligibility for these benefits.

About 70% of reverse mortgages are taken as a line of credit, but you can also take a lump sum or monthly advances, or a combination of a monthly payment and credit line. A monthly advance may lose value with inflation. Meanwhile, a credit line lets you withdraw money as you need it. Unlike with a HECM loan, the unused balance in the credit line offered by some proprietary loans doesn't grow, so make sure you check.

As you determine how a reverse mortgage fits into your long-term financial picture, steer clear of certain uses for the money. If you take a lump sum to invest in stocks and bonds, it's unlikely you'll yield more than what you'll pay in mortgage interest and costs.

Many financial planners also say there's little point in paying the fees for a reverse mortgage and then buying an annuity. "Most annuity companies charge way too much in annual fees and in initial commissions," says Donald Martin, a certified financial planner with Mayflower Capital, in Los Altos, Calif.

Be aware that reverse mortgages have become a tool of unscrupulous salespeople. Avoid brokers who pressure you to take out a reverse mortgage in order to sell you life insurance or annuities. "The only person who benefits is the salesperson who gets a high commission," says Renée Shadel, an investigator with the Washington state attorney general's office.

If you go for a reverse mortgage, only consider lenders who are members of the National Reverse Mortgage Lenders Association (**www.reversemortgage.org**). To find a counselor, go to the HUD Web site (**www.hud.gov**, click "Talk to a Housing Counselor"). And if you want to read more, check out AARP's Web site (**www.aarp.org/revmort**). K —**LEAH DOBKIN**